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Royal Commission on Banking and Finance

CANADIAN ASSOCIATION OF CONSUMERS

PROFESSOR E. P. NEUFELD

Hearings
held at

OTTAWA

Vol.

53

Date.

October 25, 1962



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I N D E X

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Professor E.P. Neufeld

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ROYAL COMMISSION ON BANKING

AND FINANCE

Hearings held at Ottawa,
Ontario, on Thursday,
October 25th, 1962.

THE COMMISSION

The Honourable Dana Harris Porter
Chief Justice of Ontario
Toronto, Ontario - Chairman

Mr. W. Thomas Brown, M.B.E.
Investment Dealer
Vancouver, British Columbia

Mr. James Douglas Gibson, O.B.E.
Banker
Toronto, Ontario

Mr. Gordon L. Harrold
Agriculturalist
Calgary, Alberta

Mr. Paul H. Leman
Corporation Executive
Montreal, Quebec

Mr. John C. MacKeen
Corporation Executive
Halifax, Nova Scotia

Dr. W.A. Mackintosh
Vice-Chancellor
Queen's University
Kingston, Ontario

Mr. H.A. Hampson

- Secretary

Mr. Gilles Mercure

- Joint Secretary



Ottawa, Ontario,
Thursday,
October 25th, 1962.

--- At 9.20 the hearing commenced.

SUBMISSION OF

THE CONSUMERS' ASSOCIATION OF CANADA

APPEARANCES

Mrs. W.T. Wilson - Chairman,
Committee on
Consumer Credit

THE CHAIRMAN: We will now consider the
brief of the Consumers' Association of Canada. Mrs.
Wilson, I understand that you wish to present certain
opening remarks.

MRS. WILSON: Thank you, Mr. Chairman.

THE CHAIRMAN: It is not necessary to stand,
unless you wish to do so.

MRS. WILSON: No, Mr. Chairman, I would
prefer to sit, if it is all right.

THE CHAIRMAN: Yes, the proceedings are
quite informal.

MRS. WILSON: Thank you. Mr. Chairman and
gentlemen, I should like to present a short statement
which would be supplementary to our brief. I will not
read the brief, if you do not so require.

We have already stated in our brief to this
Royal Commission that the Consumers' Association of
Canada is dedicated to the protection of consumers
and to supplying shoppers with information necessary
for wise buying for their homes and families. Consumer



1 spending has become very big business; according
2 to the Dominion Bureau of Statistics, it was \$24 billion
3 253 million for 1961. Consumer credit is increasingly
4 used in the purchase of consumer goods. In 1960
5 Mr. E.F. K. Nelson of the Canadian Retail Federation
6 stated at the Standing Committee of the Senate on
7 Banking and Finance, "The primary object in retailing
8 is the sale of merchandise. Credit is one of
9 the tools that assist retailing in attaining this
10 primary object." This form of sales promotion was
11 developed, not to serve the consumer but as a matter
12 of business because the "buy now, pay later" way
13 of doing business has proved profitable. Risks
14 are small compared with rewards in credit granting.

15 In 1960 it was reported by credit granters
16 that 70 per cent of customers paid their instalment
17 debts in routine manner, 29 per cent after collections
18 and one per cent uncollectable. In its issue of
19 February 8th, 1961, the Financial Post reported,
20 "National Retailers point out that normal write-off
21 credit losses run about .4 per cent of total
22 instalment sales; .16 per cent of total retail
23 sales. Many merchants no longer check customers'
24 credit rating -- such procedure would cost more
25 than their losses."

26 Consumer credit is a permanent part of
27 our economy, and its wise use is commended by
28 our organization. This can only be accomplished
29 by knowing all the facts pertinent to purchasing
30 credit. In our competitive economic system, the



1 very heart is freedom of choice in the marketplaces
2 of our country. However, free choice must go
3 hand in hand with knowledge, otherwise free choice
4 ceases to be free. We need knowledge of price,
5 quality and quantity. To obtain this knowledge,
6 our organization is constantly pressing for accurate
7 labelling and standards for consumer goods. So
8 it follows, logically, that when consumers purchase
9 credit they have a right to all information
10 necessary for comparative credit shopping.

11 Three times our organization supported the
12 intent of disclosure bills as presented by Senator
13 David Croll in the Senate, and I would like to
14 comment on various questions raised by critics
15 of Senator Croll's bills. The first problem raised
16 is the legislative jurisdiction.

17 In 1960, during the debate and hearings
18 on Bill S-25 opponents of disclosure of the cost of
19 credit expressed in terms of annual interest expressed
20 the opinion that Bill S-25 did not fall within the
21 legislative jurisdiction of the Parliament of Canada.
22 They maintained that it would be a law relating to
23 "property and civil rights in the provinces" and
24 that only "interest" charges were in the jurisdiction
25 of the Federal Government. The Chairman of the
26 Standing Committee of the Senate on Banking and
27 Finance obtained an opinion on this point from
28 Mr. E.R. Hopkins, Law Clerk and Parliamentary
29 Counsel. This is in the appendix to the Senate
30 Debate, February 2nd, 1961. Our organization, a



1 lay organization and not competent to investigate
2 legal matters, is very grateful to Mr. Hopkins for
3 his clear explanation of this matter.

4 Mr. Hopkins explained that, in the long-run,
5 this was a decision for the Canadian Courts,
6 particularly the Supreme Court, and that his
7 opinion was "studied speculation". We quote Mr.
8 Hopkins, "Having in mind the foregoing, it is
9 my opinion that Bill S-25, if enacted, would
10 constitute valid Federal legislation".

11 He based his opinion largely on the
12 Federal Parliament's decision in passing the Small
13 Loans Act in 1939. The decision hinged partly
14 around the "cost of the loan" which included
15 interest and other charges necessarily incidental
16 to it. This "cost of loan" in the Small Loans
17 Act is expressed as a "percentage" rate. Mr.
18 Hopkins drew no distinction between "finance charge"
19 as in Bill S-25 and "cost of loan" in the Small
20 Loans Act. On this point I would like to draw the
21 attention of the members of the Commission to a
22 recent development in Ontario. For the past 50
23 years, many people have held the view that the
24 Unconscionable Transactions Relief Act of Ontario
25 protected the public in Ontario from unreasonable
26 interest rates. Recently, this Act was challenged
27 in the courts and the Ontario Court of Appeal held
28 the Act to be unconstitutional and "clearly invalid
29 as an infringement of the exclusive legislative
30 power committed to Parliament". This quote is from



1 Mr. Justice Schroeder in the Globe and Mail of
2 October 17th, 1962.

3 In a report of this case, it was stated
4 that Dean Rand, a retired Judge of the Supreme
5 Court, held the view that interest includes all
6 compensation paid by a borrower to a lender. Our
7 association asked Dean Rand if this were a true
8 report of his view. In reply to a letter, Dean Rand
9 wrote, "that such charges have been looked upon by
10 Courts as interest is unquestionable". His further
11 remarks on the point are contained in this letter,
12 which I would like to submit as a confidential
13 exhibit. It is here, Mr. Chairman, if you would
14 like it.

15 Since the Unconscionable Transactions Relief
16 Act has been declared unconstitutional, have consumers
17 in Ontario any protection in this field? Further,
18 we note that similar legislation in some of the
19 other provinces is now being questioned. Moreover,
20 the most recent provincial legislation on this
21 subject, the Time Sale Agreements Act of Manitoba,
22 has not yet been proclaimed.

23 The second point raised is this, the claim
24 that consumers are not interested in the percentage
25 rate, and "This information is of no practical use
26 to consumers". We dealt with these views at some
27 length in the brief; that full information is the
28 right of every purchaser, regardless of its use.
29 On this point we quote from Dr. Wallace Mors,
30 Professor and Chairman of the Division of Finance,



1 Babson Institute, Western Reserve University,
2 who was formerly an economist with the Federal
3 Reserve Bank of Chicago. Discussing the percentage
4 cost of credit in a little booklet which he wrote
5 called "Consumer Credit Facts for You" we quote,
6 "Many instalment sellers say that customers are
7 interested in dollar costs but not in percentage
8 rates. Legislative reports show clearly that
9 greater interest in percentage rates would save
10 consumers considerable money and worry. Here is
11 a challenge for consumer education".

12 Our association is most concerned over the
13 degree of consumer ignorance concerning credit
14 contracts. We deplore the fact that some consumers
15 are concerned only with having sufficient cash
16 to meet monthly time payment bills. As a first
17 step to remedy this situation, we have recently
18 distributed to our members a small pamphlet,
19 "Credit Costs Money". I have a copy of this,
20 Mr. Chairman, and I would like to leave it with
21 you. Many thousands of consumers need and want
22 this information, and we reject the implication
23 that most Canadian consumers are either stupid
24 or irresponsible.

25 The third problem posed is the difficulty
26 in computing percentage rates. We appreciate those
27 retailers and finance companies who state clearly
28 the cash price and the total time sales price in
29 their contracts. Often they provide a table with
30 most of this pertinent information about the contract.



1 However, wherever there are variations from one
2 contract to another in either time or money, it is
3 impossible to do comparative shopping for credit
4 unless the "finance charges" are expressed in terms
5 of simple annual interest. We request that this
6 unit of comparison, percentage rate, be added to
7 the information furnished to purchasers. The
8 method of calculation has already been discussed
9 in the brief.

10 Some fears have been expressed for small
11 retailers faced with difficult algebraic formulae
12 should they be required to furnish such percentage
13 rates. In point of fact, most of these dealers
14 work with a finance organization who buy the contracts.
15 These companies provide charts and mathematical
16 tables which retailers use in setting up their
17 credit contracts. These tables could readily
18 include an annual rate chart. In this case,
19 mathematical difficulties would be removed from
20 both the retailer and the purchaser.

21 The fourth problem posed is this; the
22 claim that "percentage rate would result in exposing
23 apparent exorbitant rates" and would result in
24 confusion and deception. As stated in our brief,
25 we fully understand that extending credit for
26 small amounts for a short time necessarily costs
27 much more than large amounts for a long term when
28 expressed as an annual percentage rate. For example,
29 a firm extending credit for \$3,000 for one year
30 could not, profitably, use the same rate in extending



1 credit for the same amount in small loans of
2 \$200 for one year. It would require much more time
3 and effort -- probably fifteen times more -- to
4 lend \$3,000 in amounts of \$200 than in one transaction.
5 We understand the hesitancy of ethical credit granters
6 who consider that they may be accused of excessive
7 rates by uninformed consumers if they publish the
8 effective annual interest rate in credit contracts.
9 Many of the public cling to a long established,
10 erroneous opinion that all rates should be in the
11 order of 6 per cent. Our organization fully
12 recognizes that much higher rates than this are
13 necessary for most short-term credit contracts.

14 Most certainly, concealment of rates is
15 not the answer. Consumer education in this matter
16 is the responsibility of both the Consumers'
17 Association of Canada and the industry. We are
18 delighted to find universities are recognizing
19 the need for education in this field, and we would
20 like to draw your attention to the extension course,
21 "What you should know about interest rates" being
22 offered now at the University of British Columbia.
23 I have a little account of this, Mr. Chairman, if
24 anybody is interested in it. It is about this
25 extension course which the University of British
26 Columbia is offering.

27 We consider that stating percentage rates
28 would force unethical credit granters to reduce
29 their rates or get out of business. This curb,
30 we are sure, would be welcome to ethical finance



1 organizations. Competition would prove an incentive
2 to increased efficiency in the industry which, in
3 turn, we hope would lead to lower rates and a
4 greater volume of business. At the same time,
5 the informed consumer could balance the cost of
6 credit against his need for consumer merchandise.
7 Business and consumers would both be served.

8 THE CHAIRMAN: Thank you, Mrs. Wilson.

9 We shall now proceed with the discussion.

10 COMMISSIONER MACKINTOSH: I have one or two
11 questions, Mrs. Wilson, that I should like to ask.
12 In the submission which you have just read -- I
13 am not sure whether it was a quotation or a statement --
14 it seemed to say that consumer credit had been
15 developed, not to serve the consumer but merely
16 to make a profit. Isn't the evidence, surely,
17 that it was something the consumer has wanted to
18 buy?

19 MRS. WILSON: I was quoting from Mr. Nelson
20 of the Canadian Retail Federation in this case;
21 but my point is that when the retail merchants
22 extend credit, they do so as a tool of merchandising.
23 Actually, we look upon it, from our standpoint, as
24 a sales promotion matter.

25 This is one way that has been really most
26 useful to retail crediting. Actually, as you know,
27 retail creditors have made a great deal of money
28 both from selling merchandise and also from the
29 business of extending credit. It has been a very
30 lucrative business as far as they are concerned.



1 COMMISSIONER MACKINTOSH: As I recall it,
2 when the Federated Council of Sales Finance Companies
3 was before us, this is the way they represented it;
4 that this was a matter of merchandising.

5 MRS. WILSON: That is right.

6 COMMISSIONER MACKINTOSH: And, incidentally,
7 credit. I do not think anybody has any argument
8 on the desirability of the most meaningful disclosure
9 that can be arrived at. Some of us that are a little
10 slow at arithmetic may be confused by the various
11 devices. I am not sure that the formula which you
12 have adopted is necessarily completely unequivocal,
13 the one in your main submission, where you give
14 a couple of examples on page 2.

15 MRS. WILSON: There is a matter of three
16 per cent difference in that one. We chose that
17 particular example because we were not trying to
18 pick out something that was extraordinary; this is
19 just average. I might state that the formula used,
20 which is one of the Federal Reserve Board of the
21 United States, we do not necessarily say is the right
22 formula; we just suggest it as one that might be
23 used, and we consider that we should leave this
24 matter to the Government of Canada to decide the
25 best formula to use.

26 Incidentally, Dr. Mors chooses this same
27 formula; it just happens that he does. He speaks
28 of it as the "constant ratio formula" in his book.

29 COMMISSIONER MACKINTOSH: As was pointed out
30 to me in some arithmetic that seems to add up, if



1 store B added \$10 to the cash price and made it
2 \$325 in your illustration ---

3 MRS. WILSON: Yes.

4 COMMISSIONER MACKINTOSH: -- and left the
5 same down-payment, and took a monthly payment of
6 \$14.25, so that the total money paid would still be
7 \$342 ---

8 MRS. WILSON: Yes.

9 COMMISSIONER MACKINTOSH: Then store B
10 would have got just as much money under your
11 illustration, but they would have taken \$10 more
12 in principal and \$10 less in interest, and their
13 percentage would have worked out to 15.4.

14 MRS. WILSON: Yes; but if store A used
15 our formula exactly, and store B did it this other
16 way, and their cash price was quoted as \$325 instead
17 of \$315, if one is an astute consumer one would
18 realize that the value was not correspondingly as
19 good in store B as in store A. If you understand
20 the value of the merchandise you are buying ---

21 COMMISSIONER MACKINTOSH: Not being an
22 astute consumer, I would not know. If one cash
23 price was \$350 and another was \$325, and one charged
24 16.3 per cent interest and the other charged 15.4
25 per cent interest, I think I would be inclined to
26 pick it by colour.

27 MRS. WILSON: What I would like to point
28 out is, if the cost of the loan was given in dollars,
29 in one case it is given as \$54 and in the other
30 case it is given as \$57. If you added \$10 to the



1 cash price, this would show the cost of the loan
2 as \$47 and the cash price as \$325. So this problem
3 that the retailers raise, that the extra cost
4 would be buried in the cash price, would apply as
5 much if the cost of the loan was expressed in dollars
6 as if it was expressed in a percentage rate. The
7 cost of the loan would appear as \$47 instead of
8 \$57. That would be, in turn, burying something
9 in the cash price. I cannot understand why this
10 would happen more often if it was a percentage rate
11 rather than if it was a cash price, the cost of
12 the loan in dollars and cents. I cannot see what
13 difference it would make. If one was attempting
14 to bury the charges, this is what they are doing.
15 If you bury it by reducing the dollars and cents
16 cost of \$10 and added it to the cash price, you
17 would be doing exactly the same thing.

18 COMMISSIONER MACKINTOSH: Yes, that is
19 essentially what you do, because it is what you
20 call the dollars and cents ---

21 MRS. WILSON: You realize that your cash
22 value is not good at \$325; that is the only
23 thing. You must be an informed person shopping.

24 COMMISSIONER MACKINTOSH: On other matters
25 that you have raised and which concern the Commission,
26 have you carried out any surveys or obtained any
27 information through your Association as to what,
28 in this field, affect consumer purchases? Do
29 they give more attention to changes in the quoted
30 cash prices, or in the credit charges, or in the



1 amount of the monthly payment?

2 MRS. WILSON: We feel that if the consumers
3 become correctly educated, the amount of the monthly
4 payment in relationship to the weekly pay envelope,
5 or the monthly pay envelope, will not be the
6 important thing. This is the thing that we
7 deplore.

8 COMMISSIONER MACKINTOSH: Will not be?
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1 MRS. WILSON: Will not be. But we feel that
2 they will be more interested in the cost of the
3 merchandise, the cost price of the merchandise, and
4 the percentage cost, as well as the dollar cost over
5 a period of time. The difficulty is that so many
6 people are only interested in what they are able to
7 pay for monthly, you see, and this is what throws
8 things very badly out of perspective.

9 COMMISSIONER MACKINTOSH: You are inclined
10 to think that under present circumstances that is
11 what --

12 MRS. WILSON: No, this does not represent
13 all consumers or most consumers, just some consumers.

14 COMMISSIONER MACKINTOSH: I am not sure
15 we are understanding each other. You mean those
16 concerned with the monthly payments?

17 MRS. WILSON: And not with the total cash
18 price or the cost of the merchandise relative to, let
19 us say, the yearly budget. It is very, very bad
20 planning and this is something which our organization
21 deplores and we are doing everything in our power to
22 rectify. Do I make myself clear now?

23 COMMISSIONER MACKINTOSH: Yes.

24 MRS. WILSON: The yearly budget of the
25 consumers is what concerns them most, not whether they
26 are able to meet a single payment each month. This
27 seems to be the only point which is of concern to
28 people who are uninformed.

29 COMMISSIONER MACKINTOSH: When do you think
30 the consumer is likely to postpone a purchase, when the



1 cash price goes up or when the monthly payment goes up?

2 MRS. WILSON: When do I think they are likely
3 to postpone their payments?

4 COMMISSIONER MACKINTOSH: Yes.

5 MRS. WILSON: I think if consumers were
6 better informed and were able to relate their pur-
7 chases to their general budget, then they would be
8 more apt to postpone payments when they could not
9 afford them in relation to their general budget. I
10 think when percentage rates are shown and they discover
11 that something is going to cost 25 or 30 per cent to
12 carry, it will give them cause for thought, whereas
13 the dollar costs are difficult to relate.

14 Actually, you know, the average person
15 considers that 6 per cent is a good interest rate,
16 but we know that this is wrong in relationship to
17 instalment buying. Nevertheless, if they do read
18 that something is going to cost them 30 per cent or
19 40 per cent, then I think the average thoughtful person
20 is going to stop.

21 COMMISSIONER MACKINTOSH: I am going beyond
22 your submission. Control of consumer credit may be
23 a matter of some concern at some time, and control
24 depends on varying some of the elements that go into
25 it. I was trying to take advantage of your knowledge
26 and experience to see whether you could tell me which
27 of these elements, not waiting too long for the consumers
28 to become informed, but taking them as they are -- which
29 of these elements, if varied, would likely have an
30 effect on the rate at which they were purchased?



1 MRS. WILSON: I report that I feel
2 that the rate of using consumer credit will depend
3 very largely on consumer education. I really feel
4 that this is the crux of the matter so far as we
5 are concerned.

6 MRS. PLUMPTRE: May I speak to this?

7 COMMISSIONER MACKINTOSH: Yes indeed, Mrs.
8 Plumptre.

9 MRS. PLUMPTRE: I should like to add that
10 in my experience with welfare organizations, as well
11 as consumer organizations, that certainly at the present
12 time I would feel that the most important factor for
13 most people is the rate of monthly payment, for this
14 is what is pushed up to them when they go into stores.
15 So many sales are made by not saying, "This is the
16 total amount it will cost you", but by saying, "Surely
17 you can afford \$2.50 a week, and you can pay this
18 over a long period". That is the important thing
19 to a great number of people. This is something we
20 regret, of course, and we feel, as Mrs. Wilson has
21 said, that if they had to be shown a contract at the
22 time of sale on which it was clearly stated that the
23 total cost of the credit on the purchase represented
24 30 per cent or 25 per cent on the amount the purchaser
25 was paying, that gradually people would become more
26 aware of the fact of how much extra they were paying
27 to buy their goods on a time basis.

28 It is difficult to weigh each factor against
29 each other, but certainly I am sure that at the moment
30 people do not realize enough just how much they are



1 paying in extra cost for buying on a time basis.

2 MRS. WILSON: May I say in connection with
3 this that I attended a panel in Montreal some time
4 ago, at which a dealer was present who was dealing
5 in time credit payments. He was asked what the cash
6 price was of the commodities he was selling and he
7 replied, "We never sell for cash."

8 Actually there was no cash price in this
9 particular case, and his customers were coming in and
10 buying on a monthly basis and had no conception of the
11 time price element. The only concession they got was
12 a free cup of coffee.

13 COMMISSIONER MACKINTOSH: You mean, they
14 had no conception of the cash price?

15 MRS. WILSON: None whatever. I doubt
16 whether a cash price was ever stated.

17 COMMISSIONER MACKINTOSH: There are dealers
18 who will not sell for cash.

19 MRS. WILSON: This is it. This particular
20 dealer was asked by a member of the panel what the
21 cash price was of his merchandise and, as I said before,
22 he replied, "We do not have a cash price. We never
23 sell for cash." So, I suspect the only prices quoted
24 were the time payment amounts. This is the sort of
25 thing that does happen among uninformed people.

26 COMMISSIONER MACKINTOSH: That is true of
27 some dealers. It is simply a time price.

28 MRS. WILSON: There is no cash price.

29 COMMISSIONER MACKINTOSH: And it is divided
30 by a number of instalments.



1 MRS. WILSON: That is right.

2 MRS. PLUMPTRE: We have not done an actual
3 survey, but certainly from the reports we have received
4 and examples of advertisements that have been sent
5 into us, we feel this is a growing method of selling.
6 This is certainly true in the furniture field, where
7 the dealers desire to sell in this way and are not
8 interested in giving the cash price at all.

9 COMMISSIONER MACKINTOSH: The only organization
10 I know that does this, depends on the repeat sales
11 from customers who come in and make their monthly
12 payments and cannot leave the store without purchasing
13 something else.

14 MRS. PLUMPTRE: That is right.

15 MRS. WILSON: That is a weakness in human
16 nature.

17 THE CHAIRMAN: As I understand your position,
18 in all time transactions there must be a cash price,
19 there should be?

20 MRS. WILSON: There should be a cash price,
21 and that cash price should be stated.

22 THE CHAIRMAN: And anything that is paid
23 over and above the cash price is cost of the credit?

24 MRS. WILSON: Yes.

25 THE CHAIRMAN: And the cost of the credit
26 should be assessed in the percentage of the cash price?

27 MRS. WILSON: That is right.

28 THE CHAIRMAN: It is as simple as that.

29 MRS. WILSON: Just as simple as that. The
30 point is this, and I tried to illustrate this by using



1 an example but unless the percentage rate is stated
2 which, if the amounts vary by a few dollars of the cash
3 price, or the time varies by a matter of even months,
4 then it is utterly impossible to make a comprehensive
5 rational comparison without a comparative rate. Unless
6 one was an astute mathematician it would be impossible
7 to do it, and I doubt whether a mathematician himself
8 could do it quickly. It is as simple as that.

9 Just as we feel we need protection in the matter of
10 labelling and standards, we feel we should be able to
11 shop comparatively for goods which are sold on the instal-
12 ment plan, and that we should know the comparative
13 costs of the instalment schemes.

14 THE CHAIRMAN: It is all very well for them
15 to juggle the cash price to arrive at a rate of interest
16 that looks attractive, but if that cash price is not
17 the same as the cash price they are offering generally
18 for cash sales --

19 MRS. WILSON: It would not make any sense.

20 COMMISSIONER MACKINTOSH: Have you any views
21 as to whether the institutions or enterprises offering
22 consumer credit are adequate, that there is sufficient
23 competition in the field? Does it serve all classes
24 of consumers readily?

25 MRS. WILSON: Well, I do know that in respect
26 to the instalment credit finance field I read a newspaper
27 report the other day that there were 150 of these
28 institutions and six of them were very large. Certainly
29 some of them are very large, well-run institutions, and
30 I think some of them are intrinsically honest and ethical,



1 and some of them on the fringe are not.

2 COMMISSIONER MACKINTOSH: I take it you
3 would find that fringe in almost any group. You
4 have not any specific information about the kind
5 of practices that you would find on the fringe?

6 MRS. WILSON: I would suggest that people
7 who sell on the instalment plan without having a
8 cash price at all, that this is rather to be questioned.
9 There is a certain credit union that publishes a little
10 paper called "Credit Union News", and recently I was
11 reading in it about auto finance charges. They are
12 interested, of course, in this sort of thing. They
13 say that with an accredited auto finance company with
14 respect to a loan of \$500 on a new automobile the true
15 interest rate is 16 per cent; on a one to two-year
16 old car it is 22 per cent, and on a car over two
17 years old it is 26 per cent.

18 We understand why this is, but they went
19 to other car dealers who did not work with an accredited
20 finance company and they found that their general
21 rate was 32 per cent. It would be quite difficult,
22 probably, for some people who did not understand this
23 to realize just exactly what was happening to them.

24 I should like to refer to Senate Hansard
25 when Senator Croll's bill was being discussed. He
26 gave an illustration of a shopper going to various
27 stores in Toronto and purchasing furniture and appliances.
28 At a home furnishing store, on a \$350 sale, the rate
29 of true interest was $25\frac{1}{2}$ per cent on a 2-year contract.
30 At a large departmental store, which was a very sound



1 institution, it was 15 per cent, and in an appliances
2 store, on a \$230 cash price sale, the carrying charges
3 were 31½ per cent. It was more than double. It does
4 not make sense.

5 THE CHAIRMAN: Those rates are all based
6 on the same thing.

7 MRS. WILSON: Yes, the same man computed
8 them all.

9 COMMISSIONER MACKINTOSH: Have you any
10 views in the field of economic monetary policy on the
11 usefulness of having direct controls on the volume
12 of consumer credit to regulate down payments?

13 MRS. WILSON: I must say that this is beyond
14 my competence. I really do not know.

15 COMMISSIONER MACKINTOSH: Those are all the
16 questions I have, Mr. Chairman.

17 COMMISSIONER LEMAN: What would you think,
18 Mrs. Wilson, to an alternative, that the formula or
19 a couple of formulae be supplied to the purchaser,
20 to the consumer, with the goods --

21 MRS. WILSON: You have seen the formulae?

22 COMMISSIONER LEMAN: -- so he could figure
23 it himself, if he wants to, if he is interested?

24 MRS. WILSON: You have seen these formulae?
25 Do you think that all consumers, even some who are
26 quite thoughtful and astute, could actually work this
27 out satisfactorily? There are plenty of chances for
28 error. You have to fill out half a dozen amounts
29 in the correct places, and you work out a formula.
30 I do not think this is very fair. Why should this be



1 necessary?

2 COMMISSIONER LEMAN: Suppose the dealer
3 makes an error when he works out the formula on various
4 goods he is selling in his store. Would this be
5 something he could be sued for? If he makes an
6 error and misrepresents the rate of interest, could
7 he be sued for this?

8 MRS. WILSON: Suppose he makes an error.
9 He might very easily make an error in the total cash
10 payment which would be required -- the dollars and
11 cents instalment payments. This is what a great many
12 firms are requiring nowadays. Perhaps somebody could
13 tell me. Is he liable to be sued in that case?

14 COMMISSIONER LEMAN: What do you mean?
15 What kind of an error?

16 MRS. WILSON: I suppose the finance company
17 would just have to absorb it in that case, if it was
18 wrong. However, I should think that if it were a
19 deliberate deceit, that he would definitely be responsible.
20 But I would not be prepared to say what would happen in
21 the case of an honest error. I think it could be
22 easily proved, and actually the rate charts so far
23 as most finance companies are concerned are worked
24 out to the percentage for the exact amount of credit
25 extended. I have seen some of these rate charts.

26 COMMISSIONER LEMAN: I am just wondering
27 about a store owner who carries 400 or 500 items that
28 he wants to sell on credit and he has to tag each one
29 with this interest charge. You see, there would be
30 plenty of opportunity for error.



1 MRS. WILSON: Yes, but as to the actual
2 dollars and cents amounts of the time sales payments,
3 do you think he could work them out?

4 COMMISSIONER LEMAN: He has to do it.

5 MRS. WILSON: Then, if he can do that is
6 there any reason why, if he has proper charts, that
7 cannot be converted to a percentage rate? I mean, if
8 he can do one he can do the other.

9 COMMISSIONER LEMAN: I am not implying he
10 cannot do it.

11 MRS. WILSON: If he can work out the total
12 cost time sales price -- you understand what I am trying
13 to say? -- then he can work out the percentage rate.

14 COMMISSIONER LEMAN: I am sure he can,
15 but I am suggesting he can make an error, and would
16 that be misrepresentation?

17 MRS. WILSON: I would say it would be
18 misrepresentation, of course. It would be a very wrong
19 thing to do, but I do not think this is apt to happen
20 any more than a mistake in calculating the total time
21 sales payments.

22 COMMISSIONER BROWN: I think one of Mr.
23 Leman's points is that if this is going to be established
24 by statute and the retailer has to do this, what do
25 you recommend the statute provide in case he makes an
26 error?

27 MRS. WILSON: That would be something for
28 them to consider. This is a matter we have not particularly
29 considered at all, but I should think in consideration
30 of the bill --



1 COMMISSIONER BROWN: What suggestion would
2 you like to put forward?

3 MRS. WILSON: You mean, should this be
4 a criminal offence?

5 COMMISSIONER BROWN: Or should it require
6 an adjustment in the price, or what do you suggest?
7 I think that is what Mr. Leman was trying to get at.

8 COMMISSIONER LEMAN: Yes.

9 MRS. WILSON: I see your point, Mr. Leman.
10 I noticed Senator Croll said in relation to his bill
11 that if the dealer did not provide the percentage rate
12 which should be required by legislation, that all
13 finance charges be removed from that particular sale.
14 Perhaps this sort of thing might be done.

15 COMMISSIONER MACKINTOSH: Perhaps, Mrs.
16 Wilson, like many eminent finance institutions, he
17 could put at the bottom, "errors and omissions excepted".

18 MRS. WILSON: Actually you cannot protect
19 the consumers from themselves, if mistakes are made.

20 COMMISSIONER BROWN: Along the same line
21 I should like to ask to what decimal point should this
22 disclosure be carried?

23 MRS. WILSON: I suggest that it be left
24 to the Government of Canada to decide the accuracy
25 and method of preparing these formulae. This is what
26 was suggested in the bill, and I personally believe
27 that our organization does not feel it needs to be
28 carried to two or three decimal points. I would
29 think that a half a per cent to one per cent error
30 is not --



1 COMMISSIONER BROWN: In other words, if you
2 obtained a statement that the interest charge was between
3 15 and 15½ per cent. or something like that?

4 MRS. WILSON: Between 15 per cent and 15½
5 per cent; let us put it that way. I was going to say
6 that in reading the material about these formulae in
7 respect to the Federal Reserve system, which has been
8 referred to, it is suggested that they are not always
9 completely accurate. There is an error of a decimal
10 point as far as the Federal Reserve system is concerned,
11 Dr. More, in his book, says that when it gets to be
12 over a term of three years the percentage of error
13 becomes much greater. This is something which again
14 would have to be taken into consideration. This is
15 quite beyond our competence, but I am sure the Govern-
16 ment of Canada would be able to adjust this.



1 Now, the consumer is not interested in the
2 third decimal place; we are interested in something
3 that is accurate enough to help us make a rational
4 decision. Remember, that keeping house is a business
5 just like anything else, and financing a family
6 and a home is like anything else and I can't see any
7 particular reason why we shouldn't have the protection
8 of a percentage rate when we do instalment buying,
9 the same as any other business has percentage rate
10 protection when they buy, and when they buy on credit.

11 COMMISSIONER BROWN: You mentioned the
12 statute that controls the loan companies, and this
13 imposes maximum rates of interest that may be
14 charged?

15 MRS. WILSON: Yes.

16 COMMISSIONER BROWN: Including all the
17 financing?

18 MRS. WILSON: Yes, that is right.

19 COMMISSIONER BROWN: Have you any suggestions
20 that there should be a maximum simple rate of interest
21 permitted?

22 MRS. WILSON: I think at this time the
23 thing we are interested in is to get full disclosure
24 and see if this will not right a great many of the
25 wrongs which are now existing in the credit granting
26 field. I think that it would be a great pity to
27 divert our attention at this point, and I have
28 not competence to decide on this point and our
29 organization has taken no decisive stand.

30 THE CHAIRMAN: You took the 16.3 per cent



1 in your store A figure?

2 MRS. WILSON: Yes.

3 THE CHAIRMAN: And does that include
4 any service charges?

5 MRS. WILSON: This includes everything.

6 THE CHAIRMAN: That is the cost of the
7 credit?

8 MRS. WILSON: That is the complete cost
9 of the credit.

10 THE CHAIRMAN: It has been held that that
11 would be all these items which are included?

12 MRS. WILSON: Yes, everything. That is
13 the thing; you see, if some items are included
14 and let us say that they have just put the interest
15 rate on in the old sense of the word and you have,
16 let us say, insurance expenses to put down some
17 place else, service charges some place else, this thing
18 is so diversified that the interest can very
19 easily be charged actually by segregating these
20 charges.

21 THE CHAIRMAN: That is the total compensation?

22 MRS. WILSON: That is the total compensation
23 to the lender which is paid by the borrower.

24 THE CHAIRMAN: Then, there is just one
25 other thing. In the event of default in monthly
26 payments, unless an interest rate is shown how do
27 you determine what interest rate is to be paid
28 on the defaulting ---

29 MRS. WILSON: That will be something which
30 I would think when the matter has been discussed by



1 the government in session that the rates ---

2 THE CHAIRMAN: I am just pointing out
3 that unless there is something more in the contract ---

4 MRS. WILSON: I see what you mean; an
5 actual rate.

6 THE CHAIRMAN: That is all very well if the
7 monthly payments are met regularly, that is one thing,
8 but if the monthly payments fall into default,
9 is there any interest that accumulates on these
10 monthly payments?

11 MRS. WILSON: I am sure there would be.

12 THE CHAIRMAN: At what rate? Unless the
13 rate is shown somewhere, then---

14 MRS. WILSON: In the credit contracts I
15 have examined on this point that actually is not
16 stated in the contracts, on some of the ones I
17 have seen.

18 THE CHAIRMAN: There could be an inconsistency-
19 between the statement that the monthly payments are
20 \$15.60 and the rate of interest is 16.3 per cent.
21 It is the rate of interest on what? The rate of
22 interest must be on the unpaid balance as it is
23 from time to time?

24 MRS. WILSON: Well, this contract pre-supposes
25 that the borrower meets his payments when they are
26 due and, remember ---

27 THE CHAIRMAN: I know this, but if they
28 don't, then what happens?

29 MRS. WILSON: What would the rate be?

30 THE CHAIRMAN: Yes, unless it is mentioned



1 in the contract.

2 MRS. WILSON: Yes, it would have to be
3 probably a different rate and this is something
4 which, of course, we haven't ---

5 THE CHAIRMAN: It could be that in some
6 of these contracts that is covered more definitely.

7 MRS. WILSON: I was actually interested
8 in that, because in some of the contracts this is
9 not even mentioned and I have wondered myself
10 how this was done. This probably would have to be
11 worked out in the same way as the rate for the
12 borrowers who meet their contracts, I should think
13 and, remember, as we said it is only .4 per cent
14 that do not meet their contracts.

15 THE CHAIRMAN: If there is a default in
16 a monthly payment, then the cost of a loan of
17 \$54.40 might be greater if interest is to run on
18 the defaulting payment?

19 MRS. WILSON: This is one of the things
20 which I would like to point out about this, that
21 the merchandise in these contracts remains the
22 property of the merchant or the finance company
23 until it is completely paid for, and they can reclaim
24 it. That is another thing which must be considered.

25 THE CHAIRMAN: Oh yes, but by the time
26 they reclaim it there is not very much left for
27 anybody; it is the other way around.

28 MRS. WILSON: In England, I understand,
29 if you have paid one-third of your instalment
30 payments you can't reclaim without taking it to court.



1 This is something which is peculiar, as far as
2 being different in Great Britain, and sometimes
3 a contract will have half a dozen items on it and
4 if for some reason or other you can't meet one of
5 the items on that contract -- if it is all on the
6 same contract -- the whole works, the stove, the
7 refrigerator and the chesterfield suite can all be
8 reclaimed and have been reclaimed on occasion, and
9 this works a real hardship for some consumers. I
10 was rather astounded to find that out.

11 THE CHAIRMAN: I used to have a lot of
12 claims on these contracts and with all the
13 repercussions.

14 MRS. WILSON: I would like to point out
15 that it is a very, very small minority, and in this
16 statement by the Financial Post it says that .4
17 per cent is all that are uncollectable, and this
18 is very much worth noting, and I did read some place
19 else that when it does get into the hands of the
20 collection people that they sometimes charge as
21 much as 50 per cent of the value of the goods to
22 do the collecting, so that it is a very, very small
23 proportion, actually, and I think that this risk
24 is well taken care of in the interest rates charged.

25 COMMISSIONER LEMAN: Would you hazard a guess
26 as to what percentage of the consumers in the country
27 now are paying what you would consider to be excessive
28 rates of interest?

29 MRS. WILSON: I don't think we have any
30 statistics which would prove that; we simply have



1 the rates which are charged by different firms,
2 and I think that once we get the percentage rate
3 and a proper comparative cost procedure set up,
4 certainly we would hope that due to this competition
5 that all these people who are charging excessive
6 rates would have to go out of business.

7 I mean, if it was clearly stated that A
8 charged 20 per cent and B charged 30 per cent, you
9 would be a very stupid person if you went to B
10 to do business, and I think it would put them out
11 of business and I think that the percentage of
12 excessive rates would be very greatly reduced, but
13 I don't think there is any statistic to show the
14 exact number at all and, as I said, I think the
15 cases that come to court -- I don't know too much
16 about this -- but I think it would be a very small
17 percentage, actually, I should imagine, Mr. Chairman.

18 COMMISSIONER BROWN: You mention the problem
19 of when no equivalent cash price was stated.

20 MRS. WILSON: Yes.

21 COMMISSIONER BROWN: Do you think that this
22 should be a matter of legislation?

23 MRS. WILSON: I think in all credit contracts
24 there should be a cash price, certainly, and also
25 the time sales cost, the cost of the credit, and
26 the finance charges should be expressed in dollars
27 and cents and in a percentage rate.

28 COMMISSIONER BROWN: Do you think there
29 should also be provision for people to pre-pay?
30 Suppose that they won the Irish Sweepstake and wanted



1 to pay off these contracts?

2 MRS. WILSON: This is something which we
3 haven't given consideration to. I have never won
4 an Irish Sweepstake.

5 COMMISSIONER BROWN: Suppose that somebody
6 dies and leaves ---

7 THE CHAIRMAN: You can always try.

8 COMMISSIONER BROWN: Sir!

9 MRS. WILSON: Tut, tut. In reading about
10 the hire-purchase contracts in Britain, in any
11 event, in some cases it does state that there is
12 provision ---

13 COMMISSIONER BROWN: But you haven't got
14 the information on that?

15 MRS. WILSON: No, that is something we haven't
16 come to.

17 COMMISSIONER BROWN: I would like to ask
18 you your opinion on one other thing, and that is
19 that when a period of tight money comes along and
20 interest rates go up, presumably contracts therefore
21 cost more because of the higher interest charges?

22 MRS. WILSON: Yes.

23 COMMISSIONER BROWN: Did you find in any
24 of your surveys that this builds up consumer
25 resistance; people change their minds about buying
26 thing, not as between store A and store B, but as
27 between this year and maybe waiting until next year
28 when interest rates might be lower?

29 MRS. WILSON: I think there is some evidence
30 of this in certain classifications, that goods do



1 sell more readily when there is easy money than
2 when there is tight money.

3 COMMISSIONER BROWN: Is this because the
4 financing charges are lower or because people have
5 more money?

6 MRS. WILSON: I think for the most part it
7 is because people have more money.

8 COMMISSIONER BROWN: Have you made a survey
9 at all about people's reactions to rates that are
10 offered to them on their savings; do they consider
11 this at all? Do they consider the fact that it
12 will cost me this much if I buy this now, whereas
13 if I put some money in these savings institutions
14 I can get 4 or 5 per cent, and therefore the spread
15 is that much greater?

16 MRS. WILSON: No, we have done no survey
17 on that particular item at all.

18 COMMISSIONER LEMAN: At the risk of confusing
19 the consumer ---

20 MRS. WILSON: Yes.

21 COMMISSIONER LEMAN: Any institution that
22 was a little worried about the appearance of 16
23 per cent or 19 per cent, would you allow him to add
24 in the contract that he will only net 7 per cent
25 on your money!

26 MRS. WILSON: Now, that would be a very
27 good thing. I hope you realize that I have explained
28 in the supplementary brief and in the original brief
29 that we fully understand that there is no relation-
30 ship between the old fashioned 6 per cent rate and



1 what credit contracts cost, and we are particularly
2 concerned about the people that enter into contracts
3 for very short-term small loans, because we realize
4 that it is really probably a nuisance in some cases
5 to credit companies to have to set up these contracts
6 for a very small amount of money, and certainly
7 in our consumer education we would point this out
8 to the consumers. I realize that they would use
9 these short-term, small amount loans just if the
10 consumer goods which they wished to purchase were
11 very vital.

12 If you had a baby and you needed a refrigerator,
13 I suppose it wouldn't matter what it cost, you should
14 buy it anyway, or if you needed a winter overcoat
15 you should buy it anyway, but I think that the
16 ability to assess the need as against the cost
17 should be very much stressed, and I do think that
18 finance companies would be well advised to do a
19 certain amount of consumer education on this point,
20 too. It is their responsibility as much as ours,
21 and we are delighted to see the university entering
22 into this field.

23 COMMISSIONER BROWN: Do you know whether
24 it is the consumers or the retailers who are taking
25 the university course?

26 MRS. WILSON: Probably it would do the
27 retailers a great deal of good to take the course;
28 it is offered by the University of British Columbia
29 and anybody that is a citizen has the right to
30 take the course.



1 COMMISSIONER GIBSON: Have you got any
2 other views or has your Association any other views
3 about consumer credit matters which you want to
4 express to us? We have heard quite a lot of views
5 with regard to control of consumer credit; is
6 there anything else that you have to say on this?

7 MRS. WILSON: No, nothing in this area.
8 We feel that our interest should not be diverted
9 on this point from this one point of full disclosure,
10 and if we get that it may be that the consumers
11 are their own best credit managers; it may be
12 that anything more will not be necessary, but let
13 us get this one vital point across which we consider
14 is self-evident as something we need to do intelligent
15 shopping.

16 THE CHAIRMAN: Thank you very much indeed
17 for your brief and for the discussion.

18 MRS. WILSON: You are very welcome.

19 THE CHAIRMAN: We have learned a great deal
20 this morning, I think, and perhaps in a different
21 light than before.

22 MRS. WILSON: Thank you very much.

23 THE CHAIRMAN: We will adjourn now for 15 minutes.

24 --- Recess
25
26
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29
30



SUBMISSION OF

PROFESSOR EDWARD .P. NEUFELD

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THE CHAIRMAN: Professor Neufeld, I think I owe you an apology for delaying your submission in the way we have on I think two occasions. However, we are very pleased indeed to have you with us today. We have all read your brief with great interest and look forward to the discussion that will ensue.

I do not know whether you have in mind making any preliminary statement or not, but that is entirely up to you to decide. It is not necessary to do so unless you wish.

PROFESSOR NEUFELD: Well, Mr. Chairman, I would just like to say that it is an honour for me to be given this opportunity to appear before you. Also I should like to say that one of the consequences of being somewhat delayed in appearing before you is that the Bank of Canada and Canadian banks have presumably read my brief and have decided to revert to a fixed bank rate and introduce bankers' acceptances, so that there are certain modifications that would now have to be made in that direction if I were to revise my brief. Apart from that I have really nothing else to say in the way of an introductory statement.

COMMISSIONER GIBSON: Mr. Chairman, if I might open up I should like to ask Professor Neufeld a few questions about the objectives of economic and



1 monetary policy which he really deals with in the first
2 five pages of his brief. He makes reference to these
3 in there and elsewhere.

4 You speak, Professor Neufeld, of five
5 objectives: low unemployment, relative price
6 stability, a high rate of economic growth, fair dis-
7 tribution of the costs of instability, or economic
8 instability, and in the fifth one you suggest a
9 minimum of interference with efficient functioning of
10 the capital market. You go on to say that you think
11 that these objectives should be set out by an
12 Economic Stabilization Board and that at least an
13 annual report of the progress towards their achieve-
14 ments, problems and conflicts involved should be made,
15 and presumably should be published.

16 First of all, in regard to these objectives,
17 these are the objectives of economic policy, monetary
18 fiscal and exchange; they are not specifically monetary?

19 PROFESSOR NEUFELD: They are objectives
20 of economic policy because I do not think that it
21 is possible to segregate policy into those various
22 categories.

23 COMMISSIONER GIBSON: Do you think that there
24 are any of these objectives that are particularly
25 the job of monetary policy, or more monetary policy
26 than fiscal policy, let us say?

27 PROFESSOR NEUFELD: I do not think one can
28 say in any absolute manner that certain particular
29 objectives are more the objectives of monetary policy
30 than of fiscal policy. I think it is true that monetary



1 policy is perhaps more effective in certain regions
2 for achieving those objectives than fiscal policy might
3 be.

4 I might also add that another change from
5 the time that the brief was written is that we have
6 moved back to a fixed exchange rate. I think as a
7 result of that one would now have to add to that list
8 obviously the maintenance of the fixed exchange rate
9 as long as we are committed to a fixed exchange rate.

10 I think while one could say, for example, that
11 because over a number of years the increase in the supply
12 of money has been accompanied by an increase in prices,
13 price stability
14 is more an objective of monetary policy than other
15 types of policy. While one could argue that way, I
16 would not prefer to argue that way.

17 COMMISSIONER GIBSON: In the Netherlands,
18 as I understand it, the objective of internal and
19 external stability on the value of the currency is
20 specifically stated in legislation affecting the central
21 bank. In most countries I believe these general
22 objectives are mentioned rather than the one specific
23 one.

24 PROFESSOR NEUFELD: Yes, I think that the
25 Bank of Canada Act preamble refers in its own way to
26 the exchange rate and to internal prices. It refers
27 to a number of other things as well. I think it is
28 useful to refer to them all.

29 COMMISSIONER GIBSON: What about conflicts
30 as between the objectives? You do not say a great deal



1 about that although it is evident that you are concerned
2 about some of them as shown by your remarks about
3 cost-push inflation, for example?

4 PROFESSOR NEUFELD: Yes.

5 COMMISSIONER GIBSON: Would you care to
6 say a little more about how far you regard the objective
7 of low unemployment, or high employment, and price
8 stability as being in conflict, and under what sort
9 of circumstances?

10 PROFESSOR NEUFELD: I think that in the short
11 run there could be serious conflicts between these
12 various objectives. I think in the long run the
13 conflicts are not as obvious. The reason for this
14 is that if, for example, one tolerates a degree
15 of inflation in trying to raise the level of
16 employment, I suspect that it may work in the short
17 run, but I do not think it would work very long in the
18 long run. So that in the long run increasing prices,
19 or excessive price increases will also produce un-
20 fortunate employment conditions.

21 Also, if one said that in the long run,
22 or rather in the short run, one should try to achieve
23 certain rates of economic growth at the expense of
24 prices, again I think this would build up such distortions
25 in the economy in the form of distortions in capital
26 stock and in our balance of payments
27 position, that it too would begin to conflict with the
28 objective of long run growth and long run stability
29 in employments.

30 COMMISSIONER GIBSON: I understand the meaning



1 of your approach, that this may not be in conflict in
2 long run, these general basic objectives, but in fact
3 is not monetary policy pretty well decided by a series
4 of decisions which are made in short run?

5 PROFESSOR NEUFELD: I think monetary policy
6 is decided by a lot of decisions that are made in
7 the short run. I think that the possibility, therefore,
8 of conflicts in the short run between objectives is
9 present. I would hope that these conflicts would
10 indeed be avoided, and I think that the way that they can
11 best be avoided is for the policy makers to pursue
12 the lines of policy and the use of techniques
13 to which I have referred. For example, if one
14 pushed monetary expansion far in the short run,
15 this might be desirable for immediate employment
16 conditions, but it might conflict with future price
17 stability unless one were able to remove that liquidity
18 from the economy. .

19 Therefore, I think the mix, as outlined
20 in my brief, between fiscal and monetary policy which
21 would permit the budget to mop up some of that liquidity
22 would be essential in order to ensure that the conflicts
23 of which we have been talking would not in fact occur.
24 So, I think there is a possibility of conflict in the
25 short run. I think that they can to a substantial
26 degree be avoided with appropriate policies.

27 I might add this, that occasionally the
28 market is subjected to very severe strains of a partially
29 economic and partially non-economic character. I would
30 think that the attack on the Canadian dollar earlier on



1 in this year is an example in point and that under
2 those circumstances I think it is quite true that there
3 is conflict between the need

4 to maintain the fixed exchange rate,
5 to remove speculative forces from the market, and the
6 need to increase levels of employment. In that case
7 I would say there was a conflict. Policy had to do
8 first things first, and the first thing in that case
9 was to restore confidence in the Canadian dollar. In
10 my view this did have and probably still has certain
11 undesirable consequences for employment and credit
12 conditions in the country, but I don't think it could
13 be helped. I think there are instances when you
14 do have conflicts and cannot do anything
15 about them, and when policy-makers just have to do
16 first things first.

17 COMMISSIONER GIBSON: You do suggest that
18 a pretty deep kind of conflict may arise also when
19 you have got a cost-push type of inflation if you
20 attempt to off-set this by monetary or even fiscal
21 means?

22 PROFESSOR NEUFELD: Quite right. I think
23 that in the case of cost-push inflation there is a deep
24 conflict between maintaining price stability and
25 maintaining employment conditions. I think an
26 attempt to use what we call demand techniques to combat
27 inflation under those circumstances is certainly going
28 to aggravate the conflict between employment and prices.
29 There is always the question as to how important cost
30 inflation is. I do not know how important it is. I



1 have not seen any really convincing statistical work
2 which will throw much light on this, but I think it
3 is fairly clear that if it is important -- I think
4 it is sufficiently important by instinct, and I think
5 it is sufficiently important for one to worry about it --
6 then to use demand techniques for achieving price
7 stability will create conflict in the objectives
8 which I have outlined. I think, therefore, there is
9 no way out but to introduce other techniques so as to
10 again avoid the possibility of conflicts between
11 objectives.

12 COMMISSIONER GIBSON: Now, on the subject
13 of growth there is a basic objective. Is there a
14 conflict here, and I am thinking of the problem that
15 we have had in this country and that the Americans
16 had to some extent in the last two years, where the
17 rate of growth has slowed and almost stopped, and for
18 certain reasons in this country -- some of those
19 reasons are of a structural character and therefore not
20 readily adaptable to an increase in money supply, let
21 us say. Would you care to say a bit about those kind
22 of problems?

23 PROFESSOR NEUFELD: Yes. I think that it
24 is difficult to have sufficient perspective on this
25 problem without going back to the early 1950's. I
26 think that many of the growth problems which we are
27 experiencing now were really created in the period
28 1950 to 1956, or 1957. I think that during that
29 period the Canadian economy grew rather too quickly and
30 it created distortions in our capital stock which took



1 the form of very obvious excess capacity in a number of
2 industries, and the resources industries in particular.

3 I think another distortion that was built
4 in during that period was a very substantial trade
5 deficit. This was because we in effect fought inflation
6 during that period by importing more and more goods.
7 We succeeded reasonably well in fighting inflation in
8 that way but I think that the price that we paid for
9 that technique was to build up a level of a trade gap
10 which is difficult to remove. This meant that
11 our export industries and our import competing industries,
12 and particularly our import competing industries, have
13 not developed as well as they would have done if that
14 distortion in our trade balance had not occurred. So,
15 I think what we have seen since then is an attempt
16 to remove the distortions which were built up at that
17 time.

18 I think that once economic growth distortions
19 of that kind are developed one simply has to accept
20 the fact that it will take some time to work them out.
21 I think it has taken some time to work them out and
22 I do not think we have worked them out yet.

23 Perhaps the more disturbing part of it is,
24 to my mind, that stabilization policy has not, until
25 very recently, helped us very much to work out these
26 distortions.

27 I think in such periods, stabilization
28 policy must do what it can do to shorten the time
29 to work
30



1 out the distortions, and in this case I think that
2 what stabilization policy should have done is to
3 direct itself toward reducing substantially the trade
4 deficit. If one could have done this over a period
5 of four or five years, or perhaps even two or three
6 years, this could have been done through the techniques
7 which work through main market forces; through
8 easier credit conditions, lower interest rates
9 so a gentle reduction in the rate of exchange in an
10 orderly fashion.



1 I think that because we did not really follow that
2 course, we then had to take rather strong measures, what
3 I would call shotgun measures, to affect the exchange
4 rate and to attempt once and for all to remove this
5 distortion of a very large trade gap.

6 COMMISSIONER GIBSON: You think that if
7 monetary and fiscal methods, including a controlled
8 exchange rate, are used effectively, you could deal
9 with a period of the kind we have had in the last
10 five years; or do you need other measures as well;
11 that is, things that will correct these distortions
12 and lead to the resumption of reasonable growth?

13 PROFESSOR NEUFELD: I think this would
14 depend in part on what one regards as the nature of
15 the distortions that are present. To my mind, the
16 great distortions were an excessive capital capacity
17 in a number of industries and the large trade deficit .

18 I think monetary and fiscal policy should
19 have done rather more than they did to remove the
20 distortion of the large trade deficit. As far as
21 the excess capacity is concerned, once it is there, it
22 is there, and only the growth of sales is going to solve
23 the problem, really. So I am very skeptical as to the
24 contribution that monetary and fiscal policy could
25 have made in that direction, apart from perhaps raising
26 somewhat the level of domestic buying.

27 But there are other distortions which aggregate
28 monetary and fiscal policy really, could not
29 have done very much about, unless we use the phrase
30 "fiscal policy" in a very selective sense. For example,



1 regional policies. I think that aggregate monetary
2 and fiscal policy really could not help us very much
3 in solving the problems of growth in particular regions
4 of Canada.

5 Also, obviously, if
6 there is such a thing as an undoubtedly low level of,
7 say, technical education in Canada, there is nothing
8 that monetary and fiscal policy could do about that.
9 But I would say this, that I do not think aggregate
10 monetary and fiscal policy will make those difficulties
11 worse. I think that in many cases they will not help
12 us to solve those problems, but I do not think they
13 will make them any worse. So I do not think they
14 should be precluded from being used to correct the
15 other things merely because they will not help to
16 solve the problem, say, of regional growth or inadequate
17 educational facilities.

18 COMMISSIONER GIBSON: But you have left me
19 with the impression that monetary and fiscal policy
20 might have done more in the period of expansion that
21 preceded this problem, to prevent circumstances, which
22 have aggravated the problem, from arising, or at least
23 to lessen them.

24 Would you put the emphasis in that negative
25 sense, more than in a positive sense, of increasing
26 demand in the areas where you are trying to set a
27 decent rate of growth? I do not know if I have
28 expressed myself clearly, or not.

29 PROFESSOR NEUFELD: I understand you very well,
30 sir. My view would be that if you succeed through the



1 use of monetary and fiscal policy in minimizing the
2 distortions during a boom, that you will not have
3 the problems to cope with in the succeeding recession.
4 Therefore, the problem for monetary and fiscal policy
5 in the succeeding recession will be different. Not
6 so much need be expected of it in a succeeding
7 recession. Therefore, I hesitate to say that
8 monetary and fiscal policy will be more or less
9 effective in improving an expansion, or countering
10 a contraction, because I really see the two as
11 inter-related and that really you are already combating
12 the recession when you successfully control the expansion.

13 COMMISSIONER GIBSON: We are talking about
14 a little more than a normal expansion or recession here.
15 This was the end of the great post-war boom, when we
16 had this great surge of demand. I take it, then,
17 that it is your view that, while a reasonably rapid
18 rate of growth is a proper objective of this policy,
19 perhaps there is too much emphasis as to
20 what monetary and fiscal policy could do in this area?
21 In other words, would you say the more immediate
22 objectives were to maintain a fairly high level of
23 employment and a reasonable stability of prices?

24 PROFESSOR NEUFELD: I think I would say
25 that. I think, for one thing, a certain rate of growth
26 is defined when you say that unemployment should not,
27 on the average, go below 3 to 4 per cent. You are
28 already defining a rate of growth by saying that.

29 But if your question relates to rates of
30 growth in addition to that required to keep a sufficiently



1 large number of people working, my feeling there is
2 that in an economy such as ours, where a majority of
3 the decisions to save, to spend, to work are still
4 left to the individual, that the decision to save,
5 the decision to generate savings, should also be re-
6 garded as the prerogative of the individual and the
7 company; and that it will really be this voluntary
8 decision to save that will decide what rate of growth,
9 in addition to that which will provide full employment,
10 the economy will experience.

11 In addition, of course, there is the fact that
12 growth will depend on all the other things, the quality
13 of the population, how hard people want to work, the
14 nature and demand for the resources that the economy
15 happens to have.

16 But I think I would not make a fetish of
17 economic growth once people are gainfully employed.
18 The suggestion sometimes is made that, for example,
19 the government should tax heavily, build up a surplus
20 over many years and either use this surplus to finance
21 public capital expenditures or feed it back into
22 the private economy and let business use those savings.
23 I, personally, do not think that that is an appropriate
24 policy. I would be inclined to leave the decision
25 of the proportion of income saved as much as possible
26 to the individual.

27 Once one does that, I think one does limit
28 oneself as to the growth objectives that one can set
29 for the economy.

30 COMMISSIONER GIBSON: In other words, your



1 objective of minimum interference with the efficient
2 functioning of a capital market to quite a degree
3 determines the kind of growth and growth possibilities
4 that --

5 PROFESSOR NEUFELD: It does indeed.

6 COMMISSIONER GIBSON: Of course, there is
7 this problem of defining what growth is anyhow. It
8 is just a general term and it means different things
9 in terms of different industries, goods and services,
10 and so on. Have you any views on that?

11 PROFESSOR NEUFELD: I think it raises many
12 difficulties. I think that, since my emphasis is on
13 maintaining adequate levels of employment, and that
14 can be reasonably well measured, and that since my
15 emphasis is on -- apart from that -- permitting a great
16 deal of freedom in people's savings decisions, I am
17 probably not too concerned, about what rate of
18 growth develops or how it is measured.

19 I agree with you that there are many
20 difficulties in arriving at a unique definition of
21 growth. I do not think I can really contribute any-
22 thing to that.

23 COMMISSIONER GIBSON: One of your other
24 objectives is a fair distribution of the costs of
25 instability. There are certain devices in our existing
26 machinery, of government in particular, which are designed
27 to lessen the cost of instability, to individuals
28 particularly, and corporations to some extent.

29 Are you thinking of additional techniques
30 and methods here?

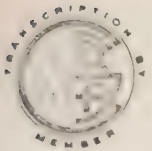


1 PROFESSOR NEUFELD: No, I do not think I am.
2 In fact, I would think that techniques that are available
3 to redistribute the social costs of unemployment and
4 instability are adequate, but they may have to be
5 extended. I think that this kind of technique falls
6 in the general category of the built-in stabilizer,
7 of which one
8 primary objective should be to pinpoint costs
9 of instability and to redistribute those costs.

10 The unemployment insurance technique is a
11 very adequate one for pinpointing unemployment and the
12 costs of unemployment. It is true that it is abused
13 and the people who know about these things have useful
14 suggestions to make as to how the abuses can be
15 eliminated. Certainly I would agree that abuses should
16 be eliminated; but I think that the technique as such
17 should be recognized as being a very useful one indeed,
18 not merely for stabilizing, in the sort of built-in
19 stabilizer sense, but also for redistributing the costs
20 of instability which we feel the economy will have
21 to bear after we have done all we can do to remove
22 instability.

23 I do not think there are new techniques
24 that need be introduced to meet this problem of instability.
25 I have no doubt that they will need to be refined,
26 because at present the usefulness of the techniques
27 is frequently detracted from by the criticism of the
28 abuses of the techniques.

29 COMMISSIONER GIBSON: I recognize that you
30 have said you do not feel there is too much use in trying



1 to say what are maximum acceptable increases in
2 price levels, nor a maximum tolerable rate of unemployment.
3 I would still be very interested in knowing what you
4 think is the maximum, long range increase in price
5 levels which is tolerable in a kind of free market
6 system that you are talking about, recognizing that
7 they vary from year to year.

8 PROFESSOR NEUFELD: Yes. I think there are
9 several things I would like to say about this matter
10 of price stability and objectives relating to price
11 stability.

12 The first one is that prices are usually
13 viewed these days in the form of indexes. Indexes
14 are imperfect. Concentration on indexes frequently
15 ignores the fact that the indexes are indeed imperfect.
16 So that I think the first thing the policy-maker should
17 do with respect to defining what price changes he will
18 tolerate is to decide what numbers he is going to look
19 at. My own feeling is that he should look at consumer
20 prices, and that ideally he should hope that commodity
21 prices will decline so as to permit the increase in
22 service prices to be offset.

23 But I would say that the policy-maker is
24 probably unrealistic if he thinks that he will be able
25 to achieve a stable consumer price index,
26 for several reasons. The first one is that the
27 consumer price index commodities may change over time,
28 and there are some diverse views as to the effect
29 of quality changes in the consumer price index on
30 prices themselves.



So I think that any official authority that speaks about inflation and price increases should first of all make certain that he is allowing for whatever quality changes are taking place.

The other thing I think the policy-maker must form a view on is the extent to which prices really reflect movements of prices in all the western world countries, and not merely in Canada.

I think it would be a very serious situation for Canada to face price increases of a kind which obviously exceed price increases in other countries. In an expanding economy, in a free, flexible, growing and innovating economy, I do not think we can say we want to have absolute price stability all the time. I think what we should guard against very carefully is that our prices do not move more quickly than is the case in other countries.

On the question as to what prices can then be tolerated in the long run, I think there is very little evidence to suggest that modest creeping up of prices is going to destroy our economy and our financial markets. Our financial markets are incredibly adaptable to such developments. That does not particularly worry me. I do think it would be very inappropriate for the central banker to say that because it has not destroyed the system, therefore he agrees that some price increases are acceptable. Perhaps I am advocating a degree of deception on the part of the central banker; I do not know. But I think the dilemma of the central



1 banker is that he does not want price increases, but
2 he does realize that there are international forces, and
3 forces of change within the economy, which might
4 on occasion lead to price increases, and these he will
5 simply, after the event, have to accept.

6 In the long run, in other words, I think
7 that our inflation must be kept under control in the
8 sense of it not exceeding the price increases of the
9 western world in general. If we do that, I think our
10 system can adapt to whatever price increases then do
11 occur.

12 COMMISSIONER GIBSON: As a practical matter,
13 you doubt if there is much point in having a view on
14 exact, long term increases for Canada, because of our
15 dependency on other countries?

16 PROFESSOR NEUFELD: I think that while
17 one could say that we do not want prices to rise more
18 than one per cent per annum, or that we do not want
19 unemployment to go higher than 4 per cent, or that we
20 want to have a rate of growth of 5 per cent per annum,
21 one can say all these things, but I just cannot see why
22 all that is very meaningful or why anyone should
23 believe me if I said it.

24 COMMISSIONER GIBSON: Mr. Bernstein, formerly
25 of the United States Treasury and of the International
26 Monetary Fund, indicated to us that he felt that you
27 pretty well had to have an annual increase in the cost
28 of living, a rising price index, for much the reasons
29 that you suggested, that it would be hard to have the
30 costs of goods going down; the cost of services would



1 increase. He could not see the cost of goods going
2 down as a long term proposition, because he felt this
3 would have a very serious effect on investment decisions.
4 Do you hold to this view?

5 PROFESSOR NEUFELD: To a degree much of
6 one's thinking about what is and is not possible
7 is based on a very unusual period in western world
8 economic history, the period of 1945 to 1957; in western
9 Europe, a bit longer.

10 I would not at all say that it is impossible
11 for commodity prices to fall gently in future, although
12 I am not sure that they can. But I do think that it
13 is not desirable for one to assume that they cannot
14 fall, and I think it is highly undesirable for the
15 central banker to say, "I do not think they can fall."
16 Therefore, my objective is to permit some price increases".

17 I think, again, one must say, "Well, I
18 think it is desirable that commodity prices do fall
19 gently to offset service prices. I hope it will happen.
20 We will try to devise techniques to help it along as
21 much as we can, and hope for the best".

22 COMMISSIONER GIBSON: Mr. Chairman, I have
23 some questions on our external economic relations
24 and exchange rate policy, but before we get on to that
25 perhaps some of the Commissioners might want to question
26 on this field.



1 COMMISSIONER MACKINTOSH: Dr. Neufeld, on
2 the point you were making last, following out his
3 argument, Bernstein said that he would rather prefer
4 wholesale prices to retail prices for reasons given.
5 Would there not be a presumption that the increase
6 in the cost of service was occasioned mainly by
7 rising levels of wages in the commodity industries,
8 which we might assume were justified by improved
9 productivity which in itself would justify the
10 balancing decline which you argued? Is that not
11 correct?

12 PROFESSOR NEUFELD: I think that is correct,
13 if I have understood your question properly. The
14 danger I see in simply taking an index which does
15 not really reflect wage increase is that it detracts
16 attention from the fact wage increases may be
17 equal to productivity increases, or they may
18 not be equal to productivity increases.

19 So, if we try to choose an index which
20 will eliminate the wage factor we might be deceiving
21 ourselves. There are occasions when inflation can
22 quite properly be related to wage increases, and
23 that is when wage increases are exceeding productivity
24 increases.

25 COMMISSIONER MACKINTOSH: I was not
26 endeavouring to rehabilitate Bernstein's policy.
27 I was just trying to spell out a little the rationale
28 of your position. In the case which you cite where
29 wage increases exceeded productivity, however that
30 might be measured, the failure to maintain a stable



1 consumer price level would be the indication that
2 these wage increases had been recognized as far as
3 the measure of the price level is concerned.

4 PROFESSOR. NEUFELD: Yes. What worries me about
5 using a measure such as a wholesale price index as
6 a guide to policy, is that I think it is much too
7 unstable. There are times when commodity prices
8 move very swiftly. They are very volatile. I think
9 it would be better in the end to use a more stable
10 index such as the consumer price index, even though
11 in the end we might have to say, "We must accept
12 the fact that one per cent per annum is accounted
13 for by changes in quality. Let us accept the fact
14 that in this connection, say, one per cent per annum
15 really reflects increased wages in the service
16 industries. I would be prepared to
17 compromise in that direction, but I would much sooner
18 focus attention on a more stable index than an
19 unstable one. These unstable commodity prices can
20 come and everyone might think in terms of deflation
21 when in fact it is a temporary thing.

22 COMMISSIONER GIBSON: I think, Dr. Mackintosh,
23 that Mr. Bernstein suggested wholesale prices in
24 industrial goods and not just wholesale prices in
25 general, which would leave out some of the volatile
26 commodities.

27 COMMISSIONER MACKINTOSH: That is true.

28 PROFESSOR. NEUFELD: Yes.

29 COMMISSIONER LEMAN: What is the fundamental
30 justification for pessimism regarding the possibility



1 of increased efficiencies in the service field?

2
3 PROFESSOR NEUFELD: I think perhaps the
4 pessimism arises from the fact that the great increases
5 in productivity that have occurred in this country have
6 occurred in the primary industries. There have been
7 very substantial increases in productivity, for
8 example, in agriculture. It is not that there is
9 no room for some increase in productivity.

10 I think the presumption is there is less
11 room for it in the service industries than there is
12 in other industries. This may well change. There
13 are innovations in this area which are somewhat
14 interesting. I hesitate to use examples because I
15 do not know how important they ^{are}/quantitatively, but
16 if, for example, there is a trend towards increased
17 use of self service, the use of self service drycleaning
18 establishments, for example, and if this is multiplied
19 many times in future, then I think we may have been
20 unduly pessimistic about the potential increases
21 in productivity, even in the service industries.

22 COMMISSIONER LEMAN: Has there been much
23 careful thought given to future possibilities in
24 this field?

25 PROFESSOR NEUFELD: I doubt that there has been,
26 if only because innovation is a very unpredictable
27 thing. I do not think economists think too clearly
28 about innovation over time. Innovation is really
29 the product of the enterpriser and it can come
30 as a surprise. I think it is because it is uncertain,



1 because it is the product of the individual enterpriser
2 rather than the product of the economist, that one
3 has not probably emphasized it very much or concentrated
4 very much on it.

5 All I can say is that I would not exclude
6 the possibility of substantial increases in productivity
7 in the service industries, and I would hope that the
8 enterpriser will be up to it.

9 COMMISSIONER LEMAN: Therefore, that will
10 be one additional reason why the authorities should
11 not assume any one or two per cent increase in
12 consumer prices based solely on the wrong guess?

13 PROFESSOR NEUFELD: I quite agree, for substantial
14 successes in increasing productivity would change
15 the character of the problem. Indeed, it might even
16 be unfortunate to set up objectives, because in
17 the end it might be that the policy-maker, while
18 appearing to do well, is doing less well, because
19 of productivity increases, than he could have done.

20 THE CHAIRMAN: There is one question I
21 should like to ask. In dealing with the post-war
22 boom period, in looking back on it with the knowledge
23 you now have plus what you had at the time, could
24 you state concisely what should have been done and
25 when?

26 PROFESSOR NEUFELD: I am quite prepared to try.
27 I think for one thing, if I may simply state my
28 view on the position of the critic, that the
29 critic should not be too concerned about those people
30 who criticize him for being clever after the event.



1 I think that it is useful and necessary for there
2 to be people who are clever after the event, if only
3 to outline clearly what mistakes have been made,
4 with the hope that they will not be repeated. Therefore
5 what I am saying may well be subject to the criticism
6 that I am speaking after the event.

7 THE CHAIRMAN: I am not worried about
8 that at all. I suggested that you might state your
9 opinion based on your present knowledge plus what
10 you knew at the time. For all I know you may have
11 predicted everything that happened.

12 PROFESSOR. NEUFELD: I would say that several
13 serious mistakes were made over the post-war period.
14 The first serious mistake was made by economists
15 when they forecasted incorrectly the state of post-war
16 economic conditions.

17 They felt that we would experience a post-
18 World War I economy with a collapse of prices and
19 a collapse of employment and output. I think that
20 it took quite some time for economists to realize
21 that indeed this was not happening and was not going
22 to happen, at least not for some time.

23 The next mistake was made by the policy-
24 makers because they believed the incorrect forecast
25 of the economists, and this led them to follow
26 a policy of low interest rates for a good many
27 years. There was a period when money supply was not
28 influencing interest rates, but interest rates were
29 deciding monetary policy. During that period not
30 only was credit easy, not only was it easy for people



1 to obtain credit and expand purchases on the basis
2 of credit, but also they were able to sell Victory
3 Bonds, which they had saved up during the war years, and
4 so to push demand for the nation's resources
5 beyond the level at which price stability could be
6 maintained.

7 I think that after the event the decision
8 not to use control of the supply of money, the
9 decision rather to maintain interest rate
10 stability, was a crucial one and, it
11 appears to me to have been a crucial mistake.

12 I think perhaps another mistake, leaving
13 out all the history -- was made in the most recent
14 period of expansion, the period of 1954 to 1957.
15 The responsibility for that mistake can more nearly
16 be placed on the policy-makers than was the case
17 earlier. We did not successfully control the
18 expansion of 1954-57, because monetary policy was
19 much, much too late in combating it. Although the
20 economy moved up in the spring of 1954, we had
21 monetary expansion of a substantial size with actual
22 declining interest rates and a declining exchange
23 rate for some months after that. Once we did begin
24 to use monetary restraint we had already built up
25 a degree of liquidity through monetary expansion,
26 which I think made it quite impossible to control
27 expansion; that plus the fact we never had any clear
28 sense of what to expect from fiscal policy.

29 I think changes in fiscal policy have
30 frequently been fortuitously decided by other



1 reasons than stabilization of the economy. During
2 that time I think the burden placed on the monetary
3 policy, which was already too late, was too great,
4 that it should have been supplemented by a fiscal
5 policy of a kind which would have controlled excessive
6 investment spending and, perhaps to a degree, excessive
7 consumer spending, so that we would not have had to
8 have the exceedingly high interest rates which attracted
9 an exceedingly large inflow of capital.

10 I think these were two of the major mistakes
11 made in the post-war period.

12 I feel that the third mistake was that
13 probably all of us failed to realize the basic change
14 that was occurring in this country after 1957. It
15 really indeed was the end of an era, but it took
16 several years for all of us to realize it was the
17 end of an era. I do not think the policy-makers
18 realized it was the end of an era. The techniques
19 and policies that were followed were based on the
20 presumption that renewed, rapid economic growth would
21 be with us in a short while. This proved not to be
22 the case. So I think the third major mistake was
23 the mis-reading of economic developments after 1957,
24 and the adoption of a policy based on that mis-reading.

25 THE CHAIRMAN: Any questions?

26 COMMISSIONER GIBSON: Mr. Chairman, one could
27 think of many questions after that very interesting
28 exposition by Dr. Neufeld. I should like to go
29 back to this question of objectives, to look at the
30 external side a bit. Dr. Neufeld said that we really



1 now have another objective of economic policy, to
2 maintain a stabilized exchange rate. I should like
3 to ask him if we do not always have some objective
4 in our external economic relations, either maintaining
5 a reasonable balance between our payments and receipts,
6 or an exchange rate which would promote that kind
7 of balance? Isn't this a permanent objective of
8 economic policy as well?

9 PROFESSOR NEUFELD: I think that it is. The way
10 I looked at it was that if we followed policies
11 which would provide us with satisfactory price
12 stability, and which would avoid distortions in
13 particular sectors, that if this were done with a free
14 exchange rate, it would result in a tolerable balance
15 of payments position. I think that what has changed
16 is that we do not now have a free exchange rate,
17 and therefore the rules of the game have been
18 changed for us.

19 COMMISSIONER GIBSON: Would you care to
20 say anything about whether or not you regard
21 a fixed exchange rate as inappropriate for Canada
22 as a long-range measure or whether you think we should
23 do whatever seems most appropriate in the circumstances?

24 PROFESSOR NEUFELD: Well, I think we should do
25 whatever we think is appropriate in the circumstances.
26 As to what those circumstances are now and are
27 likely to be, my feeling is that they are not likely,
28 in a balance of payment sense, to be very different
29 in the near future than they have been in the near
30 past. This may subsequently prove to be an incorrect



1 forecast, but in view of this feeling I think that
2 Canada would have been better to have persisted
3 with its floating exchange rate than to move back
4 to a fixed exchange rate.

5 To my mind it is a fact -- and this is
6 a fact I think that other countries simply refuse
7 to believe -- that Canada's balance of payments
8 position changes very quickly, particularly on
9 capital account, and that we do have massive flows
10 of capital across our border, that this is the result
11 of our living beside an economic giant, and that
12 unless something happens to tame this capital flow,
13 perhaps exchange controls or complete disillusionment
14 of the foreign investor in Canada, or some other
15 thing -- unless something happens to tame these
16 capital flows, it would be exceedingly difficult
17 for Canada to maintain a fixed exchange rate.
18 Therefore, I would have hoped that we could have
19 used market forces to move to a dollar discount
20 and to maintain a floating rate
21 of exchange.

22 I believe we encountered trouble with our
23 floating exchange rate after we did things which
24 ceased it from being truly a floating exchange rate,
25 when we started arbitrarily to interfere with it
26 by public speeches, by using the exchange fund account
27 for other than short-term stabilization purposes.
28 Then, in the final analysis, we fixed it. But I
29 think, if we can assume that capital flows across
30 our border are going to be large and unpredictable,



1 it will be very difficult for us to maintain a fixed
2 exchange rate.

3 There is another danger and that is that
4 once you fix a rate, even though the International
5 Monetary Fund has provision for changing it, it seems
6 very difficult in this day and age to change it. In
7 looking to the period of the next two or three years,
8 I think the Canadian dollar is under-valued, and
9 because it is under-valued but nonetheless fixed, and
10 is difficult to change once it is fixed, there is a grave
11 danger that we will correct that under-valuation by
12 domestic inflation.



1 This I would regard as one of the really serious problems
2 that the policy-maker is going to have to face in this
3 country in the future, and that is to adjust himself
4 to the fact of the fixed exchange rate, and one of
5 the facts at present is that the fixed exchange rate
6 may well be undervalued, and that one way or another
7 it will have to be made the right value, either through
8 domestic inflation or by taking the initiative and
9 revaluating it upwards some time in the future.

10 COMMISSIONER GIBSON: Are you satisfied
11 that the free market produced the right value on
12 the Canadian dollar in the period from, say, 1958 on?

13 PROFESSOR NEUFELD: No, I don't think
14 that the free market --

15 COMMISSIONER GIBSON: "Right" in the sense
16 of most in the interests of the Canadian economy to
17 meet these various objectives which you mentioned?

18 PROFESSOR NEUFELD: Well, I think I can
19 see one of the difficulties that arises, when
20 one talks about a free or a floating rate of exchange.
21 One doesn't really mean that in the full sense of
22 the word because monetary policy can even then influence
23 it. I would say that the market did not produce
24 the right rate of exchange from 1958 on until recently,
25 but that it did not produce it because of incorrect
26 monetary policy impacts on the capital market. I think
27 that the market itself has done a remarkably good job
28 in managing our exchange rates.

29 The fluctuations of the exchange rate in
30 the free market have been really quite small apart from



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3 the massive changes that occurred for non-market reasons.
4 Our interest rate structure was such as to invite
5 very substantial highly interest-sensitive capital
6 to come into Canada and thereby produce
7 an exchange rate which was not appropriate for Canada's
8 economic circumstances.

9 COMMISSIONER GIBSON: You felt then that
10 had they had what you thought was a proper monetary
11 policy being pursued that we would have had a more or
12 less appropriate exchange rate?

13 PROFESSOR NEUFELD: Yes.

14 COMMISSIONER GIBSON: You don't feel that --
15 and you did earlier refer to the problems of living
16 beside a giant -- you don't feel that there are certain
17 lags and certain rigidities in the views that investors
18 in our next door neighbour's country may have from time
19 to time, and perhaps they are not too sensitive to
20 our economic affairs and may not respond very promptly
21 to economic movements. I am not expressing an opinion;
22 I want to hear what you think about it.

23 PROFESSOR NEUFELD: Yes, I have heard that
24 said. For example, people talk in terms of psychological
25 barriers in the movement of the rate, and when the rate
26 moved too far, people said that it wouldn't break through
27 par because there is a certain barrier there
28 in the minds of the traders.

29 This may be true, but the reason why I don't
30 place particular emphasis on that kind of influence is



1 that throughout this period there decidedly was an
2 interest incentive for capital to come into Canada.
3 I think if we had removed the interest incentive and then
4 still had the persistence of the capital inflow,
5 there would have been strong evidence to suggest that
6 non-market and perhaps irrational forces were
7 influencing the rate of exchange. I think during
8 this period when the gap between the United States
9 and the Canadian interest rates was persistently
10 well in excess of one-half of one per cent, that there
11 was adequate interest incentive for Canadians to borrow
12 in New York or other American investors to invest
13 in Canada pay securities.

14 COMMISSIONER GIBSON: But there were other
15 capital movements during this period, and I wouldn't
16 call them non-market or non-rational; they probably
17 made good sense in the terms of the people who were
18 making the decisions. There was a big inflow of
19 direct investment in the purchase of assets
20 during a good part of this period and which was a
21 very substantial proportion and perhaps acted in a
22 manner that didn't fit Canada's immediate economic
23 interests and yet may very well have fitted the interests
24 of the people who were making the investments. Do
25 you recognize the existence of this sort of problem?

26 PROFESSOR NEUFELD: Yes I do, and I asked
27 myself the question, how much of the capital inflow
28 is interest sensitive? I would think that direct
29 investment in Canada is not interest sensitive. I
30 think that the flow of securities is.



1 We have on several occasions, in several
2 years, 1957 and again in 1959, had substantial borrowing
3 by Canadian provinces and municipalities in New York.
4 This reached levels which I think had a major effect
5 on the rate of exchange. Also, I think that the
6 swing in that account should not be underestimated
7 because it is possible for that account to move not
8 merely to zero but to a substantial minus through
9 redemptions of securities. Therefore I would think
10 that there is a large volume of interest sensitive
11 capital which would have reacted to a reduced
12 gap between Canadian and United States interest rates,
13 although I certainly agree there is a good part
14 of the capital inflow which is not so sensitive.
15 I would hope that we would not need to go to the position
16 where we cut off capital. I think that whatever
17 capital comes into the country in response to views
18 of investors as to profit opportunities should be
19 permitted to come in.

20 COMMISSIONER BROWN: There is quite a large
21 bit of inflow, too, because of the tax situation in
22 the United States?

23 PROFESSOR NEUFELD: Yes, certainly; inflow
24 into non-resident funds.

25 COMMISSIONER BROWN: And into privately
26 held real estate.

27 PROFESSOR NEUFELD: And into privately
28 held real estate. I can hardly
29 regard this as interest sensitive, I wouldn't think
30 it was very interest sensitive.



1
2 COMMISSIONER GIBSON: Do you think we
3 should look to solution or possible solution of this
4 problem of flexibility in the interest rate towards trying
5 to get a widening in the I.M.F. arrangements, a
6 widening of the margin of variation? Do you think
7 that such an effort should be made and would be worth-
8 while from the Canadian point of view and, secondly,
9 do you think we would have any chance of achieving
10 such an objective?

11 PROFESSOR NEUFELD: I think that a
12 widening of the limits wouldn't be very useful, because
13 I think that these limits are useful primarily to permit
14 speculators to speculate against the currency. As
15 long as a speculator can see that there is a limit
16 to the movement of the rate in certain directions,
17 he will have an unsettling effect.

18 Unless one thinks of a substantial broad-
19 ening, for example, a movement of the rate of exchange
20 7 or 8 per cent in either direction, unless one thinks
21 of that kind of a limit, I don't think it would be a
22 very useful thing for Canada to try.

23
24 COMMISSIONER GIBSON: It is one per cent
25 now, plus or minus?

26 PROFESSOR NEUFELD: Yes.

27
28 COMMISSIONER GIBSON: What about 5
29 percent?
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1 PROFESSOR NEUFELD: I don't think so. I
2 would think that it would give the speculator in hot
3 money much more incentive to move.

4 I think if you are going to have a limit
5 as such that it must be a very narrow limit, and that
6 if you wish to compromise by using a fixed rate and
7 a floating rate, there is no happy ground in
8 between; I think it must be a very narrow limit or
9 no limit at all.

10 COMMISSIONER GIBSON: The British have
11 managed to work under this system, and while it is
12 true that their capital problems, their international
13 capital problems are different from ours, but they
14 are exposed to big movements and they manage to
15 work on the one per cent reasonably well.

16 PROFESSOR NEUFELD: I think that my argument
17 hinges on the size and volatility of capital flows.
18 If it were decided in the long run that we wish to
19 maintain a fixed rate, my view would be that we should
20 then take supplementary measures to control capital
21 flows, exchange controls of some kind.

22 Now, I admit frankly it is in the end
23 a matter of judgment; that capital flows, we know
24 from our 1950 experience, or even earlier on, we know
25 from our experience this year, that capital flows
26 can certainly be overwhelming. We can say that
27 this will not happen again in the future or that with
28 a sufficiently large exchange reserve perhaps we could
29 have overcome this speculative problem. I can only
30



1 say from all the things which I have seen that I have
2 come to the conclusion that our capital flows at
3 various times in the future will once more be over-
4 whelming, and that we would be better to have a floating
5 exchange rate than a fixed exchange rate to meet these
6 capital flows.

7 I might say that at present we are placing
8 a very substantial burden on interest rates to offset
9 these capital flows. We really now find ourselves
10 in a position where the only technique we really have
11 is to change the amount of reserves and to use interest
12 rates. I don't think that in view of the size of the
13 capital flows that interest rate technique is up to it.

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1 COMMISSIONER GIBSON: You don't think
2 a marked improvement in our liquidity, in our
3 reserves, would be big enough to give us the amount
4 of leeway that we might need?

5 PROFESSOR NEUFELD: I don't think so,
6 because I think that while one could see our reserves
7 built up to 2½ to 3 billion, maybe 3 billion 5,
8 I think that you would still occasionally have --
9 it is not merely the possibility that our reserves
10 will run out, it is also the kind of market conditions
11 that are created when there is pressure on the
12 reserves in one direction or another. I suspect the impact
13 on the market and market psychology, on the attitude
14 of foreigners towards Canada, would be as great
15 if our reserves moved from 3,000 to 2,000, than if
16 they moved -- as they did -- from just around 2,000 down
17 to 1,000. I think both would be an indication
18 that something was wrong, so I think that the solution
19 does not lie entirely in simply building up
20 our reserves of exchange.

21 COMMISSIONER GIBSON: You have expressed,
22 Professor Neufeld, a good deal of faith and
23 confidence in the working of the "price of the
24 market" system. Now, this is the only area where
25 I detect any doubt; the external relations. You
26 suggest the possibility of exchange controls in
27 dealing with these capital inflows from time to
28 time.

29 PROFESSOR NEUFELD: Yes.

30 COMMISSIONER GIBSON: Is that the only



1 qualification, major qualification, which you would
2 have in your emphasis on the marketplace?

3 PROFESSOR NEUFELD: Are you confining
4 your views to the balance of payments position?

5 COMMISSIONER GIBSON: No, I was thinking
6 of the workings of monetary policy.

7 PROFESSOR NEUFELD: It is not, really;
8 there are several other areas. I would say, though,
9 that while I mentioned that one would have to go
10 to exchange controls, I think, if one wished to remain
11 with the fixed exchange rate, that my preference --
12 as I mentioned before -- is not to resort to
13 exchange controls and I would regard it as a very
14 grievous error on the part of Canada if we were
15 to do that. But I do have some other reservations
16 about the mechanism of prices. All of this I think
17 arises from fundamentally the same reason, and
18 this is that there are times when sheer optimism --
19 not always justified -- creates capital flows which
20 could become de-stabilizing. I have mentioned in
21 several other places in the brief where I think that
22 there are times when businessmen simply become too
23 optimistic about the returns that they are going
24 to get from the capital they are putting in place,
25 and I think that there are times when the consumers
26 really pay no attention to what credit is
27 costing them in fulfilling their desires for
28 consumer durable goods, and I think what one is really
29 saying is that, certainly in the first case -- not
30 so much in the second -- but in the first case what



1 one is saying is, "Well, there is a possibility that
2 the price mechanism isn't working, because why would
3 a businessman put capital in place on which he will
4 in the end get a rate of return which is not adequate?"
5 and yet we have seen, I think, that this has happened.
6 Then I would say because of this we may have to use some
7 supplementary techniques and that is why I think there
8 are times when we have to supplement the market
9 techniques of monetary policy with techniques such as
10 variable depreciation allowances, which in fact is a
11 change in the corporation income tax, in order to ensure
12 that optimism doesn't get out of hand.

13 Now, I wouldn't regard this as a continuing
14 need because I think that year in and year out the
15 investment decisions of business are reasonably good
16 and satisfactory, but I think they can become somewhat
17 overly optimistic and that on those occasions the
18 country can suffer as a result of mistakes made by
19 business.

20 COMMISSIONER GIBSON: Thank you very
21 much.

22
23 COMMISSIONER BROWN: Before we leave
24 the exchange situation, you mentioned the problem that
25 arises when reserves were down from \$3 billion to
26 \$2 billion, or \$2 billion to \$1 billion, and I think
27 it is in these directions that most people think
28 of problems in exchange.
29
30



1 Would you care to discuss the problem
2 that arises when pressures are built up in the other
3 direction and you are faced with maintaining a fixed
4 exchange rate and you have to find the money to
5 pay for this and what this does to the interest
6 rates?

7 PROFESSOR NEUFELD: This is a very serious
8 problem and I would regard it as just as serious
9 as pressure on the dollar downward. In 1950 we
10 had pressure on the dollar upward and we at that
11 time used several expedients to finance the capital
12 inflow. Arrangements were made to sell securities
13 directly to the banks, which had an instantaneous effect
14 on the supply of money. In the end we even financed
15 through the Bank of Canada, because the Bank of
16 Canada began accumulating foreign exchange on its
17 own account and this increased the cash reserves
18 of the banking system and produced, therefore, in
19 this case multiple expansion of the supply of
20 money. So we know from experience that financing a
21 capital inflow, particularly when there has been no
22 warning that the capital inflow is coming,
23 can begin to interfere directly with our objectives
24 of maintaining monetary stability, and this certainly
25 is something that has to be kept in mind.

26 The other problem is this, and it is in a
27 sense the danger to which I referred
28 earlier, that if you have an upward pressure on
29 the rate of exchange, I think the first reaction
30 of the policy-maker will be to try to sit it out.



1 It is not easy to go to I.M.F. and say,
2 :"Let us move the rate up a bit", and soon a bit more,
3 and so on. But what we are really saying when we
4 say that we will try to sit it out is that
5 we have to finance the inflow and this may
6 be inflationary; it may be that the pressure on the
7 dollar reflects a basic change in Canada's
8 comparative costs with other countries. Now, to
9 prevent the exchange rate under these circumstances from
10 moving up might mean that the steam that is being
11 built up will be let off by domestic inflation
12 and not by a break in the exchange rate.



1 So I would think that both the problems of financing
2 an increase in foreign exchange holdings and the
3 definite possibility that we will move toward the
4 adjustment by domestic inflation constitutes serious
5 problems when there is an upward pressure on the
6 rate of exchange.

7 COMMISSIONER LEMAN: Professor Neufeld,
8 even if the rate is not floating it can be changed?

9 PROFESSOR NEUFELD: The rate can be changed.
10 I think that we now have moved into a world where
11 changes in the rate of exchange have become a matter
12 of national pride rather than a matter of economic
13 reality. For example, I think at the present the
14 reason why there is a good chance for the American
15 dollar to remain stable is because there is going
16 to be relative inflation in Western Europe.

17 Ideally what one would have expected under
18 these circumstances would have been that the American dollar
19 would have depreciated and Europe would have been
20 possibly able to maintain their price levels. That
21 is not what is going to happen. What will happen
22 is that you will have relative inflation in Western
23 Europe because everyone feels that they must maintain
24 exchange rate stability. This is an institutional
25 rigidity, I would say, and presumably if economists
26 were in charge this would not be a problem, but I
27 think one must face the fact that economists are
28 not in charge.

29 COMMISSIONER BROWN: I wonder if I could
30 just switch to a slightly different aspect of this



1 thing. In our hearings we have had many interesting
2 discussions about the effectiveness of monetary
3 policies, fiscal policies and debt management. We
4 find monetary policy administrators are not too
5 optimistic about the effectiveness of monetary
6 policy, and think that fiscal policy would be more
7 effective, and fiscal policy people think that the
8 real effectiveness lies in monetary policy. You
9 are objective in this in that you are looking at it
10 from outside and not having to administer either.
11 Can you discuss just how effective these are?

12 PROFESSOR NEUFELD: Well, I would begin
13 by again saying that I think that I prefer to think
14 of them all as one policy, because I think you can
15 argue that the Minister of Finance too can affect
16 the supply of money, and one can argue that the
17 central bank too can have an influence on the budget,
18 and that debt management also is intimately related
19 with monetary policy. So that in an operational
20 sense, quite apart from common objectives, I
21 think it is very difficult to distinguish between
22 the two.

23 I think what one must ask oneself is
24 not whether monetary policy is effective, or whether
25 fiscal policy is effective, but rather whether
26 the techniques which are designed to move interest
27 rates are effective, whether this is through debt
28 management, through monetary management and so on.
29 This is the way I prefer to look at it.

30 I would say that if one assumed that what



1 monetary policy does primarily, but not exclusively,
2 and it is not unique in this -- if monetary policy
3 primarily moves interest rates and alters credit
4 conditions that the effectiveness of monetary
5 policy can be discussed from that point of view.
6 My feeling is that the real significance now to
7 remember about interest rate movements; movements
8 which also affect availability of credit, affect
9 market expectations, affect business expectations,
10 is that all these factors enter into the marginal
11 price decisions in millions of transactions, and
12 that while one cannot see the effect of this on
13 any individual transaction, one really has not got
14 any conclusive proof until one can sum up the
15 effects on a million transactions. This is something,
16 while it is not unique to monetary policy,
17 is very important, and perhaps more important in
18 respect of monetary policy than it is in respect of
19 other types of policies.

20 Now, to what extent can one say that it is
21 in total very effective? I think again what one
22 must remember is that its ineffectiveness in the past
23 has been based in part on the limitations of the
24 money managers. Whether it will be effective in
25 the future will depend in part on what assumption
26 we can make in respect of the qualities of central
27 bankers. My opinion is that money management is a
28 very new technique. I think we did not use it until
29 the 1950's. We did not use it in the 30's and we did
30 not use it until the early 50's because we managed



1 interest rates. We did not manage the supply of money.

2 For this reason I would think one should
3 not get too pessimistic and say that the reason that
4 monetary policy, and therefore, interest rates and
5 credit availability, does not work is because of the
6 limitations of the people that inevitably will
7 have to work the machine. If we assume that we will
8 have reasonably competent people working the machine
9 then my instinct is, based I think in part on watching
10 the reactions of people who were caught in tight money,
11 monetary policy can have a substantial effect on
12 the movement of the economy. I would say it works
13 through the influence on cost of credit, on the
14 return on savings, on the ease with which credit
15 can be attained, on the fact that institutions are
16 reluctant to lend if they have to take capital
17 losses, on the fact that some of them simply will
18 not, after the experience of 1920's, charge
19 exorbitant interest rates on mortgages so lending
20 is simply cut off at certain levels, and on the fact
21 that expectations are generated, as well as on the
22 fact that businessmen who hold big inventories look
23 not at the marginal interest costs of carrying that
24 inventory, but entertain the possibility that bankers
25 will tell them that they will not have any loans
26 at all.

27 Because of all those things my own
28 feeling is, and if you press me I would
29 embarrassingly have to say I cannot
30



1 quantify it, because of all this I think monetary
2 policy has a very substantial role to play.

3 COMMISSIONER BROWN: How about fiscal
4 policy and debt management?

5 PROFESSOR NEUFELD: Well, fiscal policy
6 has two types of roles to fill, in a way. One where
7 it directly, in a mechanical way, supplements monetary
8 policy.

9 I think one of the substantial difficulties
10 in respect of monetary policy is that it is too
11 inflexible in this sense of the word, that if you
12 feed out too much money during a recession you might
13 find that economic conditions change and you want to
14 get some of it back. For the Bank of Canada to try
15 to get all this back through the narrow channel of
16 the capital market will, in a very short period of
17 time, exert much too much pressure on the capital
18 market. In the end it would be possible, but I think
19 it would create distortions and chaos to a degree
20 which would not be desirable. Therefore, I think
21 if we want to have a degree of flexibility in the
22 operation of the central bank we must also have
23 available to the central bank the possibility of the
24 budget gathering in of some of this liquidity
25 through a surplus and through leaving that surplus
26 idle in government accounts with chartered banks.
27 Therefore I think fiscal policy can help monetary
28 policy quite substantially.

29 The other role I think that fiscal policy
30 must play -- two parts of a role, really -- is first



1 to provide the mechanism for distributing the cost
2 of instability. I do not see how it can possibly
3 be done through monetary policy or any other technique.
4 I think fiscal policy must be of a kind which ensures
5 that whatever costs -- social costs, are created by
6 economic instability will be borne equitably. This
7 involves the correcting system of unemployment
8 insurance in particular, and perhaps other techniques.

9 Also fiscal policy I think has a very
10 important role to play in ensuring that there is
11 some sort of balance between the capital stock
12 that is built up in business in the private sector
13 and the capital stock that is built up in the public
14 sector. I think we have to face the fact that a
15 significant portion of our capital stock now is
16 public capital stock. Only fiscal policy can ensure
17 that it is adequate.

18 I think another thing to remember is that
19 public capital stock might be highly productive.
20 The rate of return, if you could measure it, of some
21 public capital projects might be very high indeed.
22 Therefore, not only is it desirable for the public
23 capital stock to be maintained, it might on certain
24 occasions be highly necessary if rates of growth are
25 to be maintained.

26 As far as debt management is
27 concerned, I am relatively skeptical about its
28 usefulness as a technique.

29 I think if one defines debt management
30



1 as an attempt to change the yield curve, that its
2 usefulness in this respect is very restricted. I
3 would not eliminate it. I would think that if there
4 are conditions when it would be desirable for
5 debt management to push up interest rates on the
6 long end or short end, then by all means use it. But
7 I do not think this is a major contribution.

8 I think the major contribution that
9 debt management can make is to stay out of the hair
10 of monetary policy by not permitting debt to get
11 too short, and by making sure that debt is managed,
12 new issues are floated, in a way which does not involve
13 the central bank in massive monetary expansion.

14
15
16 There might be just one matter of definition.
17 When one says fiscal policy should build up a surplus
18 and should keep it idle, one might feel that is
19 a technique of debt management, because the alternative
20 would be to redeem some of the debt. I think in
21 that sense it is questionable whether one is
22 thinking of fiscal policy or debt management that is
23 helping monetary policy. Apart from the use of that
24 technique to change the liquidity of the general
25 public I do not expect very much from debt management.

26 COMMISSIONER MACKINTOSH: May I interject
27 a question here, Mr. Brown. You mentioned the
28 aid to monetary policy under certain circumstances
29 of a budget surplus, sterilized, if you will, in
30 government accounts. Now, in the early period you



1 were speaking of, 1955 to 1957, you suggested that
2 too big a burden was put on monetary policy, and
3 my recollection is that you had then a substantial
4 budget surplus. Now, why was too much left to
5 monetary policy? Wasn't monetary policy in a favourable
6 condition operating against a budget surplus?

7 PROFESSOR NEUFELD: I think for fiscal
8 policy to be sufficiently stabilizing it would
9 probably require a greater increase in surplus than
10 that generated by the income growth of the boom,
11 and that it would require changes -- substantial
12 changes in tax rates to be fully effective. That
13 I think was the failure of fiscal policy in that
14 period, and the other failure was that it was not
15 used to control those few sectors which were unusually
16 volatile. The resources industries
17 went ahead with no apparent restriction. I think
18 it is in that sense that fiscal policy failed.

19 Monetary policy carried too much of a
20 burden in part because it created some of the burden
21 by not becoming sufficiently restrictive soon enough.

22 COMMISSIONER MACKINTOSH: But wouldn't
23 you consider that a budgetary surplus in that
24 period was simply used to redeem debt and feed it
25 into a capital market to promote further investment?

26 PROFESSOR NEUFELD: Yes, quite right.

27 COMMISSIONER MACKINTOSH: And that the
28 idea that a budgetary surplus is deflationary and
29 a deficit is inflationary has not very much in it
30 until you find out how the surplus and deficit are



1 to be used in financing?

2 PROFESSOR NEUFELD: Yes, I agree fully.

3 I think that while a budget surplus which is used
4 to redeem debt will on balance be deflationary,
5 I think its deflationary impact will be multiplied
6 if instead of redeeming debt it were simply left
7 idle. That was not done. It should have been done.

8 COMMISSIONER MACKINTOSH: Thank you.

9 COMMISSIONER LEMAN: Professor Neufeld,
10 the phrase you used: distribute equitably the cost
11 of the instability that we cannot avoid, would
12 you extend that concept also into the field of
13 equitable distribution of the cost of the stabilizing
14 efforts that are made? .

15 PROFESSOR NEUFELD: I think perhaps you
16 have in mind the fact that stabilization policy may affect
17 certain people more than others, am I correct
18 in that?

19 COMMISSIONER LEMAN: Yes, that is it.

20
21 PROFESSOR NEUFELD: I suppose one should
22 first ask whether that is indeed the case; whether
23 monetary policy is discriminatory in an undesirable
24 fashion. If it is I think that the capital market
25 should be so improved that it is not discriminatory.
26 I must say that in spite of all the criticism one
27 has heard about monetary policy, for example, impinging
28 rather heavily on small businesses, I have not really
29 seen any convincing evidence to that effect. Studies
30 in the United States relating to businesses borrowing



1 from banks by size of business do not suggest
2 that there was discrimination against small business.
3 I suspect that precisely the same thing is true
4 of Canada, although I have not seen studies of
5 that kind in Canada. So , I doubt that all the
6 charges of discrimination are correct. But, in
7 principle, I would say that if it can be shown that
8 monetary policy is discriminatory in an economic
9 sense of the word, then it should be remedied.
10 I would prefer remedying it through removing
11 the rigidity causing the discrimination rather than
12 by additional controls.

13 I would like to point out that the
14 fact that monetary policy affects some people more
15 than others cannot be necessarily viewed as a
16 case of undesirable discrimination. I think that
17 if monetary policy works well it will be of a kind
18 which does cut out the less productive man first.
19 It will inevitably hurt some people more than
20 others. I hope it will work in such a way that it
21 will cut out the man who, while he can use the money,
22 really cannot use it very productively, and that it
23 will leave the money with the man who has a highly
24 productive enterprise in mind.

25 I admit I have not answered your question
26 except to say in principle that if there is
27 discrimination of a kind which permits less efficient
28 production to go forward and more efficient production
29 to be halted, then I would say, by all means, introduce
30 measures which will remove it.



1 COMMISSIONER BROWN: Would you discuss
2 that on a regional basis in the same sense as we
3 have been told that in various areas of the country,
4 that the particular areas at no stage got into
5 a boom condition and, therefore, when monetary
6 policies were adopted which tightened things up,
7 it was not a question of them having a boom cut off,
8 but a question of them being sterilized even more
9 than they had been before?



1 PROFESSOR NEUFELD: I think it is highly
2 undesirable to mix regional economic development
3 policies with stabilization policies. I think what
4 we should do is to decide what regional economic
5 development we want to have and permit regional
6 economic development policies to go forward on an
7 even basis, whether there are conditions of boom or
8 conditions of depression.

9 I do not think we should use aggregate
10 stabilization policies to exempt certain regions in
11 the sense either of pushing them ahead more quickly
12 during periods of expansion than is the case in other
13 areas, or to be more easy on them than we are on
14 other regions during periods of easy money.

15 I think the effect of an attempt to have
16 a regional monetary policy -- and one cannot have
17 a regional monetary policy in all senses of the word
18 "policy"; to the extent that we could, it may well have
19 the effect not of helping those regions with their
20 economic difficulties, but merely permitting certain
21 companies to go forward who do not have problems in
22 the regional sense of the word. I think the other
23 thing to remember is that it is conceptually a mistake
24 to regard an easy money policy in a regionally depressed
25 area as being non-inflationary, if there is inflation
26 throughout the rest of the country. The effect of
27 this, surely, would be for the depressed regions to
28 buy more goods from the regions that are experiencing
29 high employment and inflation, and therefore to con-
30 tribute to the inflation which is already occurring



1 in those regions.

2 One can sort of look at it from a regional
3 balance of payments point of view. If the Maritimes
4 were permitted to go forward full speed during inflation,
5 the Maritimes vis-a-vis Upper and Lower Canada
6 would develop a trade deficit, and this would be
7 inflationary for Upper and Lower Canada.

8 But I do think that what one should do is
9 start with a regional economic policy, stick with it
10 whether you have recession or inflation, and not use
11 economic stabilization policy; that is, not permit
12 economic stabilization policy to detract from or
13 add to that basic regional policy. In several senses
14 you cannot have regional monetary policy in any case,
15 because debenture borrowing in these regions is done
16 to a substantial degree in this part of the country.

17
18 The only way I can see where you could have a regional
19 monetary policy is to issue directives to the bank
20 managers of those regions and say, "You can lend all
21 the money you want to lend". I think this would be
22 undesirable, as I say, in part because it would not
23 help those regions in overcoming their problems; and
24 secondly, I think it would be asking the regional
25 manager to make judgements which are quite foreign
26 to his position as a banker, and I do not see why
27 this should be done.

28 COMMISSIONER BROWN: I was thinking more in
29 the context, is this the type of rigidity which you
30 consider should be resolved by fiscal policies?



1 PROFESSOR NEUFELD: It should be resolved
2 entirely by fiscal policies.

3 COMMISSIONER BROWN: In discussing debt
4 management you mentioned one thing that the debt
5 manager should do; that is, to try to avoid shortening
6 the debt. Would you discuss the concept of varying
7 the maturity of the debt? Would there be occasions
8 when it might be desirable to shorten the debt in
9 order to increase liquidity, in the subjective sense
10 of liquidity?

11 PROFESSOR NEUFELD: I think that there
12 would be periods when it would be desirable to shorten
13 the debt -- I think we have gone through such a period --
14 if only to shorten the debt after lengthening it in
15 the conversion. But I really wish to suggest that
16 I do not think we should shorten it so much that it
17 will cause trouble for monetary policy in a subsequent
18 period.

19 I think that the general principle that
20 there are times when you just should not borrow on
21 the long market and there are other times when you
22 should try to borrow all you can on the long market
23 is a reasonably good concept. My feeling is that,
24 while in principle there are times when you could control
25 liquidity that way, in practice the leeway which you
26 have, if you do not want to interfere with monetary
27 policy, is somewhat restricted. I would prefer,
28 rather, to handle the problem of decreasing and
29 increasing liquidity through what I mentioned before,
30 the building up and tearing down of government balances



1 with the chartered banks.

2 COMMISSIONER BROWN: Can we read into your
3 words that from the point of view of debt management,
4 borrowing should be done to fit the maturity,
5 irrespective of interest rate; irrespective of cost
6 in the form of interest rate?

7 PROFESSOR NEUFELD: I think there are many
8 times when government is faced with having to market
9 a new issue, when it is quite proper for it to borrow
10 at the least cost. I think there are conditions when
11 there probably is not any significant conflict between
12 debt management and monetary management, in terms
13 of the range of the market to which the government
14 decides to appeal. I think that a general principle,
15 that one general principle, of the debt manager still
16 should be to minimize the cost of the debt.

17 I do think there are times, however, when
18 the debt manager can well place this principle aside
19 for the moment and say that, "while it might be a
20 bit cheaper to borrow in the long end of the market,
21 in fact we think it might cause a degree of indigestion
22 in that end of the market, which would make it difficult
23 for the provinces and municipalities to borrow; there-
24 fore we will stay with a short loan even though we
25 may have to pay somewhat higher rates by turning it
26 over in the short end of the market for two, three or
27 four years".

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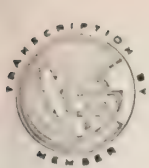


1 I do not have a dogmatic view on it, but
2 as a general rule I think the debt manager should
3 minimize the cost of the debt. I think it is
4 good discipline for the debt manager to look at his
5 task in that way. But I think there are times when
6 he can set this principle aside for the moment because
7 of the effect that his operations may well have on
8 other borrowers.

9 COMMISSIONER BROWN: Mr. Chairman, I have
10 some more questions on this subject. Is this a
11 convenient time to adjourn?

12 THE CHAIRMAN: Yes. We will now adjourn
13 until 2 o'clock.

14 --- Luncheon adjournment.
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1 --- Upon resuming at 2.10 P.M.

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3 THE CHAIRMAN: Gentlemen, we will now
4 resume.

5 COMMISSIONER BROWN: I wonder if you would
6 refer to page 17 of your brief, Professor Neufeld,
7 and to the first sentence of the main paragraph in
8 the middle of the page where you say:

9 " Monetary policy has been too inflexible
10 in the sense that the range between
11 monetary ease and monetary restriction
12 within which it has operated over
13 the business cycle has been too
14 narrow."

15 Do you mean by this that it has acted by nudges
16 rather than in greater amounts, or has this been an
17 effect of a fixed exchange rate?

18 PROFESSOR NEUFELD: I think they have
19 reacted in a nudging sort of way in part because
20 they fear that if they reacted more it would be diffi-
21 cult for them to correct their position when economic
22 conditions changed.

23 COMMISSIONER BROWN: I wonder if I might
24 interrupt you for a moment to ask the stenographer
25 to change the last words of my question. I said
26 "fixed exchange rate" when I should have said "fixed
27 bank rate".

28 PROFESSOR NEUFELD: That changes
29 my answer a little bit, I think, in the sense
30



1 that it properly focuses attention on the fixed
2 versus the variable bank rate, but I would say, on
3 the one hand, they have been inhibited in using
4 control mechanisms because, being prudent people,
5 they have to take into account the effects of their
6 actions if economic conditions change. I think that
7 to control the supply of money only through the
8 channel of the capital market limits the extent to
9 which they can vary it over the cycle.

10 With respect to the variable bank rate,
11 I think this too has resulted in a certain timidity
12 on the part of central bank action over the cycle.
13 I think one of the advantages of a fixed bank rate
14 is that it can influence expectations relating to
15 interest rates in a way that open market operations
16 never can. If, for example, during a period of
17 increasing inflation the central bank made decisive
18 moves in the bank rate, then this could begin to
19 generate all kinds of stabilizing expectations
20 without their having moved very far yet with respect
21 to money supply.

22 So, I think it is quite true -- at least,
23 I would say that monetary policy has been inflexible
24 because of the fear of not being able to offset
25 expansion so far as excess money supply is concerned,
26 and also because the bank rate was not used.

27
28 COMMISSIONER BROWN: On the previous page
29 at the top -- and this is part of your recommendation
30 that the



1 Minister of Finance should be responsible for monetary
2 policy, fiscal policy, debt management and the exchange
3 rate -- you include a recommendation that the Bank
4 of Canada Act be amended to give the Minister of
5 Finance authority to issue directives to the Bank
6 of Canada. I would like to hear from you, first,
7 a discussion of just how you think these directives
8 would work; when would they be issued; how often would
9 they be issued? It has been suggested to us by
10 some people that this might be done at regular intervals.
11 Should they be issued only when a conflict develops?
12 What sort of directives should be issued? Should
13 the directive be a public document or should it be
14 laid before parliament after a certain length of time?
15 Would you go into this a little more fully for us?

16 PROFESSOR NEUFELD: Yes. I would not regard
17 the issuing of a directive as being the usual type
18 of relationship that would exist between the Minister
19 of Finance and the Governor of the Bank of Canada.
20 I would regard it as a most unusual event. I would
21 expect that under most conditions that one can conceive
22 of the central banker would, in fact, be devising
23 policy and implementing policy, and that the government
24 would, by not interfering, in fact, be declaring
25 its agreement with this policy, and that only
26 after there was distinct cleavage of opinion as to
27 what basic policy should be -- policy relating
28 to money supply and interest rates, and, perhaps,
29 the nature of the Bank's operations in the market --
30 should such a directive be issued. I would hope



1 that the central bank could go on for many, many
2 months without ever receiving a directive from the
3 Minister of Finance.

4 Now, as to the nature of the directive,
5 as to whether it should be made public, I would
6 think that it should be made public because I can
7 conceive each issuance as being a most unusual event
8 of which the public should be aware.

9 I would not expect that it should necessarily
10 lead to a change in the governorship of the Bank of
11 Canada, because I think that the system must be
12 sufficiently flexible to allow for the vagaries of
13 personalities. A certain central banker might
14 feel strongly about something which another central
15 banker would not consider to be very important. There-
16 fore, I think the issuing of a directive should not
17 be regarded as a prelude to the resignation of
18 a governor. It could be, but it should not necessarily
19 be so regarded.

20 It should be published, I think, because
21 it would be an unusual event.

22 COMMISSIONER BROWN: Should it be published
23 at the time, or should there be some provision for
24 its appearing in the Gazette after a certain period
25 of time?

26 PROFESSOR NEUFELD: In the event of a
27 directive being issued -- a directive which does not
28 lead to the resignation of the governor -- I see no
29 reason for it to be published at the time. I think
30 that it should be published along with the other



1 major central banking policy decisions which the
2 Bank of Canada itself might be making, if only in its
3 annual report. It would, naturally, be a policy
4 decision. My view is that policy decisions made even
5 by the central bank should be published, preferably
6 in the annual report. But, the directive should not
7 necessarily be published at the time it is issued.
8 It could lead to destabilizing expectations.

9 I think if it is a sufficiently serious
10 matter and leads to the resignation of the Governor,
11 or if the Governor regards it that seriously, then
12 inevitably it would become public knowledge.

13 COMMISSIONER BROWN: With regard to your
14 concept that the Minister of Finance should be
15 responsible for these aspects of economic stabilization,
16 do I read into that that your recommendation that
17 in times of budget surpluses the government deposits
18 in the chartered banks be left there as being just
19 a flexible suggestion, or is there some rigidity
20 that you want to put on the management of the system?

21 PROFESSOR NEUFELD: I would say it should
22 be entirely flexible because -- this is a cliché --
23 different cycles are different. Under some circumstances
24 it might be quite appropriate to use the surplus to
25 retire certain debt. It depends in part on the
26 strength of the inflationary pressures that the
27 country is experiencing. But, what I would say is
28 that I think the possibility that they might be
29 left idle should be one that should actively be
30 considered. It should be recognized as a technique



1 which is available, and which will be used if
2 circumstances warrant it. My emphasis is on the
3 flexible use of different kinds of technique under
4 different economic conditions.

5 COMMISSIONER BROWN: In other words, you
6 visualize circumstances where this has accumulated
7 shortly after a period of government deficits -- when
8 deficits had built up -- in which this can be used
9 to reduce the deficit through offsetting actions by
10 the Bank of Canada?

11 PROFESSOR NEUFELD: There are times when it
12 should be used in that way, but there are times when
13 it should not. The effect of it would be that after
14 balances are built up succeeding deficits could be
15 financed out of those balances, and that would
16 preclude an increase in the public debt during a
17 period of recession. I do not think for one minute
18 it would be sufficiently large for financing all
19 the deficit at all times, but I think to some extent
20 it could be viewed as reducing the need to increase
21 the debt in a period of recession.

22 COMMISSIONER BROWN: Which is going to
23 be easier for the Minister of Finance -- to have
24 large surpluses built up in his bank account even
25 in times of prosperity when his supporters in the
26 House are asking for tax cuts, or to use them for
27 debt retiring? If he uses them then they are gone,
28 but if they are still there then there are people
29 who will want to use them.

30 PROFESSOR NEUFELD: My sympathies are entirely



1 with the Minister of Finance and his difficulties .
2 with the Leader of the Opposition. I can well
3 understand that there might be charges that he is
4 over-taxing the public because he is doing nothing
5 with the money he has already got. I can only hope
6 that the public would be made sufficiently aware
7 of where their interest really does lie in order
8 to accept this kind of technique.

9 I agree entirely -- or, at least, I
10 say, after reading the debates in the House of
11 Commons over the last few years relating to monetary
12 policy, that the use of this technique does encounter
13 political difficulties. Such charges were made,
14 and I would hope that they would not be made in
15 the future.

16 COMMISSIONER BROWN: Those are all the
17 questions I have on this point, Mr. Chairman.

18 COMMISSIONER MACKINTOSH: The real significance
19 of this operation that you suggest is simply that
20 it could be added to open market operations and,
21 therefore, the open market operations need not
22 be as large as otherwise?

23 PROFESSOR NEUFELD: Exactly, yes.

24 COMMISSIONER MACKINTOSH: And it might
25 relieve some pressure on the market?

26 PROFESSOR NEUFELD: Exactly. If it is
27 desirable to reduce the money supply by a billion
28 dollars then to think of this being done in a short
29 period of time -- in six months, say -- through
30 the narrow channel of the bond traders in Toronto



1 and Montreal, poses a very big problem for the central
2 bank.

3 I think that the period of the last few months
4 during which we have seen a reduction in the supply
5 of money in this way has been a very unusual period,
6 and we cannot count on it again. There were very
7 unusual circumstances that made it possible to do
8 this, one of the principal ones being an unusually
9 heavy demand for bonds. Ordinarily we cannot count
10 on reducing the supply of money through the market
11 without substantial disruption and chaos in the
12 market.

13 COMMISSIONER MACKINTOSH: Actually, this
14 movement of government balances has been used recently,
15 has it not, by the Bank?

16 PROFESSOR NEUFELD: Well, the movement of
17 government balances can be used in two ways for
18 purposes of controlling the supply of money. It
19 can be used in the sense of shifting government
20 balances between the Bank of Canada and the chartered
21 banks, and this is simply a cash control technique.
22 It is an open market technique really. The other
23 kind of use of government balances is such as to
24 vary the amount of government deposits with the
25 chartered banks which can be large or small depending
26 upon the debt management operations.

27 It is true that we have seen in past
28 periods a substantial build-up of such balances.
29 I think, though, that the reasons for this build-up
30 and decline have been unrelated to economic stabilization.



1 It was in part the consequence of the capital outflow
2 which caused the government to sell off exchange
3 reserves, in exchange for which they got Canadian
4 dollars to build up their balances. I think they
5 have varied substantially. I would question whether
6 they have varied in a way which was in harmony
7 with the objective of economic stability.

8 COMMISSIONER LEMAN: Professor Neufeld,
9 this morning while we were talking about the objective
10 of the debt manager, and saying it was to minimize
11 the cost of the public debt within reason, it was
12 suggested that this business of keeping large
13 surpluses in the form of deposits with the banks
14 would have quite an effect on the cost over the
15 whole cycle. That is correct, is it not?

16 PROFESSOR NEUFELD: On the interest rates?

17 COMMISSIONER LEMAN: No, on the cost of the
18 outstanding public debt, because you would have
19 substantial amounts that through the cycle would have
20 stayed outstanding, which otherwise would not have
21 remained outstanding.

22 PROFESSOR NEUFELD: This would depend on
23 the rate of interest that the chartered banks would
24 permit on government cash balances, and I think the
25 chartered banks on this score are open to suggestions.

26 COMMISSIONER LEMAN: I see. In other words,
27 these could be turned into term deposits?

28 PROFESSOR NEUFELD: I think the government
29 already receives a return on its balances with the
30 chartered banks. In the end it would really depend



1 on the difference between what the government would
2 receive on those deposits and what it was paying
3 on the debt which was not then being retired. It
4 could be the same as, or more than, or less than
5 the cost would otherwise be, depending on what these
6 rates are.

7 THE CHAIRMAN: When these deposits are
8 made with the chartered banks, the banks can use
9 that money, can they, for the purpose of loans?

10 PROFESSOR NEUFELD: Yes.

11 THE CHAIRMAN: If that is so, then that
12 money does not remain as a sterile balance, does it?

13 PROFESSOR NEUFELD: I think that there are
14 two factors there. On the one hand I think that for
15 reasons of controlling public liquidity there is
16 something to be said for controlling the amount of
17 money in bank deposits in the hands of the public,
18 and the movement of deposit accounts from the public
19 into the government account where it would remain
20 idle would, in fact, squeeze the deposit holdings
21 of people throughout the country.

22 THE CHAIRMAN: It is idle in the sense that
23 the government will not be drawing against it?

24 PROFESSOR NEUFELD: That is right, but it
25 is true ---

26 THE CHAIRMAN: But it does increase
27 the position of the bank in its loaning capacity;
28 is not that right?

29 PROFESSOR NEUFELD: It does not change
30 the loaning capacity of the bank in the sense that it



1 does not change the chartered banks'
2 assets, but I think there are two aspects to monetary
3 policy. One aspect is controlling the volume of
4 liquid assets in the hands of people, and the
5 other is controlling the amount of credit made
6 available to them. I think that you can conceive of the
7 chartered banks' assets remaining stable -- that
8 is, of bank credit not being changed, and
9 still conceive of a change in the liquidity position
10 of the people that happen to own bank deposits.

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1 COMMISSIONER MACKINTOSH: I think there is
2 a step missing -- a step that has not been mentioned.
3 These deposits, having originated in a surplus of
4 revenue, are a transfer of deposits from the public
5 to the government in the first instance. Hence, the
6 total amount of deposits has not increased.

7 PROFESSOR NEUFELD: No, the total of
8 deposits has not increased.

9 THE CHAIRMAN: I see.

10 COMMISSIONER LEMAN: If the government
11 had paid off outstanding debt instead, the public
12 would have received cash, and the money would have
13 been put right back into the banks, anyway.

14 PROFESSOR NEUFELD: Under those circumstances
15 there would have been a movement from the taxpaying
16 public to the government and then back to the bond-
17 holding public for additional investment in other
18 areas.

19 COMMISSIONER BROWN: Could not the same
20 thing be achieved by switching accounts in the
21 Bank of Canada?

22 PROFESSOR NEUFELD: If you try to achieve
23 the same thing by simply squeezing the banks' cash,
24 either by changing their reserve ratios, or open
25 market operations, or by switching accounts with
26 the Bank of Canada, then you can reduce deposits
27 only to the extent that you reduce bank assets,
28 whereas the system I envisage is one where you can
29 reduce the deposits in the hands of the public much
30 more than you reduce bank assets.



1 COMMISSIONER BROWN: Is it for this reason
2 that you are against the technique of special deposits?

3 PROFESSOR NEUFELD: I am against the technique
4 of special deposits or variable reserve ratios because
5 I think that these are simply substitutes for open
6 market operations for squeezing the cash position of
7 the banks; for forcing them to reduce their assets
8 and their deposits.

9 I am against them for two reasons. First,
10 I think in Canada the securities market is now so
11 broad that open market operations can effectively
12 control bank cash to the extent that will be required,
13 particularly since you can add the shifting of govern-
14 ment deposits to open market operations.

15 I am also against them because I think
16 if they were used it would be an indication that some-
17 thing has gone wrong with debt management -- that
18 government has been reckless, for example, in
19 financing itself through the Bank of Canada.; I do not
20 see under what circumstances one would wish
21 to use special deposits or different minimum cash
22 ratios unless there had, for some reason or other,
23 been a fortuitous increase in cash first, and the
24 reason why there might have been such a fortuitous
25 increase could be found in very undesirable financial
26 operations, I think.

27 It is true that there have been some
28 slight variations in the concept of special deposits.
29 It is sometimes said that the central banker can tell
30 the chartered banks or the commercial banks or the joint



1 stock banks, that if they increase their loans they
2 will be required to deposit additional amounts in
3 the central bank to the extent that they do increase
4 loans. Well, it seems to me that this is a very
5 round-about way of freezing the asset position of
6 the financial institutions. If the objective is
7 to freeze loans or to freeze bond holdings then,
8 surely, the honest and the straightforward way is to
9 simply freeze them and not do it in this manner,
10 which is confusing to the public, by saying: "If
11 you increase your loans we are going to require
12 higher special deposits."

13 COMMISSIONER MACKINTOSH: Would it not
14 have some advantage of flexibility in that the bank
15 that ran over its limit would have the profit taken
16 off by having to put up the cash? That would not
17 entail saying: "If you go over your limit by \$100
18 you will be subject to ten years' imprisonment."

19 PROFESSOR NEUFELD: Well, it would certainly
20 have that effect, but I would regard it as a highly
21 undesirable effect because I think there should
22 always be room in the system for the enterprising
23 bank to get ahead of the other banks if it so
24 organized its affairs that it can do this.

25 COMMISSIONER MACKINTOSH: Does that mean
26 more than it is an unusual device that should not
27 be used except in extreme circumstances?

28 PROFESSOR NEUFELD: Well, I am not sure
29 I would even want to compromise that much. I would
30 say it is an unusual device which will be used only



1 if our financial affairs have been badly mismanaged.
2 Perhaps one should permit the authorities to have
3 techniques which permit them to engage in financial
4 mismanagement, -- I don't know -- but as long as one
5 can argue that techniques of managing cash are now
6 adequate (and that is my view) I see no need for
7 those other kinds of techniques.

8 COMMISSIONER BROWN: How about offsetting
9 the inflationary effects of foreign exchange movements?

10 PROFESSOR NEUFELD: Well, I think that
11 it is desirable to keep the foreign exchange reserves
12 out of the balance sheet of the Bank of Canada.
13 As long as you do this it will not have too much of
14 a direct effect on the operation of the Bank of
15 Canada in the Bank of Canada's control of cash,
16 because there will be a movement, really, of funds
17 in and out of the exchange fund account and the govern-
18 ment's balance with the chartered banks. I would
19 prefer this to remain the arrangement. As long
20 as it does I do not think the inflows and outflows
21 of exchange will affect the central bank. It is
22 only when the central bank starts buying exchange on
23 its own account, as it did in the latter part of 1950,
24 that that conflict begins to appear.

25 COMMISSIONER BROWN: How about when it
26 has to finance the government?

27 PROFESSOR NEUFELD: It is true it is an
28 additional charge on government, and under those
29 conditions the question is: What is the most
30 appropriate way of financing the inflow?

1 COMMISSIONER BROWN: I am thinking of ways
2 of evading the multiplier effect which is forced upon
3 us by the fixed exchange rate.

4 PROFESSOR NEUFELD: I think it should
5 be done by financing directly through the chartered
6 banks, and not through the Bank of Canada. We must
7 envisage that as a very unusual event, and in the past
8 we have seen, on several occasions, the government of
9 Canada selling special short term bonds to the chartered
10 banks to provide it with the funds necessary to finance
11 the great capital inflow.

12 The alternative would have been to finance
13 this through the Bank of Canada. If it was financed
14 through the Bank of Canada it would lead to a
15 multiple extension in the supply of money which would
16 be highly undesirable. So, while there is much
17 to be said against the special arrangement whereby
18 the government sells particular issues to the
19 chartered banks, I think that in those unusual
20 circumstances that is the least undesirable way of
21 doing it.

22 COMMISSIONER MACKINTOSH: I have a few
23 questions. The first relates to your interesting
24 proposal that an Economic Stabilization Board should
25 be set up. As you outlined on page 2, it is to
26 be composed of representatives from the relevant
27 government departments and the Bank of Canada,
28 assisted by a permanent chairman and research staff.
29 Is there any particular significance in your use of
30 the term "representatives"? Do you mean to include the



1 Governor or the Deputy Governor of the Bank of Canada,
2 or the Deputy Ministers, or have you just left that
3 open?

4 PROFESSOR NEUFELD: I would certainly
5 hope that one of the representatives would be the
6 Governor or the Deputy Governor, just as I would hope
7 that normally the representatives from the various
8 government departments would be the deputy ministers
9 or the assistant deputy ministers.

10 COMMISSIONER MACKINTOSH: Now, these are
11 to be responsible for appraising the problems of
12 unemployment, inflation, and economic growth, for
13 appraising the effectiveness of, and planning and
14 co-ordination of, monetary, fiscal and exchange
15 rate policy, for seeking improvements in stabilization
16 techniques in monetary, fiscal and debt management
17 policies, and for making recommendations to the
18 government of the day. That is certainly work which
19 ought to be done. I am a bit concerned in that in
20 some measure you are asking the deputy ministers
21 or the assistant deputy ministers to review the
22 effectiveness of their ministers' policies and
23 operations, and then requiring them to put in
24 reports. I am not concerned that the ministers'
25 faults should be exposed, but I think that one result
26 of such an operation is likely to be that you would
27 get a rather smooth and not very revealing report.
28 There is a hard choice here between a report containing
29 recommendations which goes to the government and
30 which the government passes on, and one which is sent



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1 over the government's head to the public and which
2 the government is then left to explain.

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1 PROFESSOR NEUFELD: This is a difficulty
2 which I think has to be avoided. I don't in any
3 sense see this report as being anything other than
4 an expression of the views for which the government
5 will accept responsibility. I don't think that it
6 is possible, in a system of responsible government,
7 to have a supra government board or committee, and
8 that is why I feel that the board itself must be
9 right within the government. The report that they
10 make public must be a report which enjoys the
11 support of government.

12 This might mean that the report isn't
13 always as useful as it would otherwise be, but in
14 some respects it might be even more useful because
15 this would give one a clear impression, to the
16 extent that the report said anything at all, of
17 what the government has done to meet problems,
18 what its policies have been; and I think it would
19 encourage them to think rather fundamentally about
20 the difficulties of the techniques that they have
21 used and it would permit an outsider like myself
22 to form a judgment as to whether they have done all
23 that they could do. I wouldn't really like a
24 report that couldn't be said to express the views
25 of government because, as an interested outsider,
26 I would wish to be able to criticize government,
27 not an independent board.

28 COMMISSIONER MACKINTOSH: Well then,
29 don't you really have to have at least the nominal
30 composition of the board; the ministers and the



1 governor, and the actual work might be done by
2 the representatives, and the other technique is to
3 have the board produce only the first draft which
4 is then edited after consultation with the government
5 and then let somebody ask Parliament for the production
6 of the first draft?

7 PROFESSOR NEUFELD: I don't think they
8 could get it if they asked for it.

9 THE CHAIRMAN: Well, are not the senior
10 civil servants put in an awkward position; it would
11 be known that certain civil servants are members
12 of this board?

13 PROFESSOR NEUFELD: Yes.

14 COMMISSIONER MACKINTOSH: The document
15 is a document which presumably is prepared by
16 the senior civil servants?

17 PROFESSOR NEUFELD: Yes.

18 COMMISSIONER MACKINTOSH: And if the
19 government didn't agree with any aspect of it, those
20 aspects would have to be changed?

21 PROFESSOR NEUFELD: Yes, they
22 would have to be changed.

23 COMMISSIONER MACKINTOSH: So that really
24 you are not getting the report of the civil service
25 who more or less are held responsible for it in the
26 eyes of the public in view of the fact that they
27 are known to have written the report and that they
28 are members of this committee, so that really it is
29 a report of the ministers?

30 PROFESSOR NEUFELD: It is a report of the



1 ministers, but I hope its quality would be greatly
2 better than it would be if the ministers themselves
3 wrote it!

4 COMMISSIONER MACKINTOSH: But the ministers
5 never write many reports; they undoubtedly have other
6 people to do that, but generally what is written is
7 what the minister wants to have put in it, and the
8 civil servants are anonymous?

9 PROFESSOR NEUFELD: Yes, I agree entirely.

10 COMMISSIONER MACKINTOSH: But if you have
11 a special commtttee set up, I suppose it would have
12 to be set up under some sort of a statute, wouldn't
13 it, and with certain departments represented? At
14 any rate, it is a committee of certain people who
15 are deliberating on the report in the eyes of the
16 public and it would have the stamp of approval of
17 certain civil servants whom they regard as non-
18 political and independent, but in reality it is
19 a report of the government or of certain ministers
20 of the government?

21 PROFESSOR NEUFELD: In reality it would
22 have to be that, and I can only say I really wouldn't
23 want it any other way.

24 COMMISSIONER MACKINTOSH: Because ministers
25 are always calling in the senior deputies when
26 several departments are involved; it is a common
27 practice to have senior officials constantly in
28 session and discussing major problems and different
29 problems require a different assortment of senior
30 civil servants, perhaps, but nevertheless that is the



1 usual practice in the government?

2 PROFESSOR NEUFELD: I think that it may be,
3 but I don't think that there has been sufficient
4 attention paid to the huge problem of growth
5 and inflation and employment in the past; I think
6 that it has been viewed in various ways by various
7 departments of government, and for purposes of the
8 budget a statement is made and certain other
9 individual reports are made, such as investment
10 intention reports, but I don't think that an outsider
11 can say that there is a particular group somewhere
12 that is occupying its full time with the problem
13 of economic growth and employment and price
14 stability.

15 I think the advantage, if there is an
16 advantage, in this kind of board or commission is
17 that this would be seen to be their major responsibility;
18 they would not be preoccupied with other departmental
19 matters and they would be required to indicate to
20 the public the kind of work that they are doing
21 and the views that they have formed and their
22 interpretations of economic events as they see them;
23 but that if the outsider is to be in a position to
24 be able finally to criticize the expressed
25 government view on policy, then the report the Board
26 writes must enjoy the support of these responsible
27 ministers.

28 I think that there is not any radical
29 departure from what is done in an informal way now.
30 I would hope that it would result in much greater



1 concentration on the really huge economic problems
2 of the country.

3 COMMISSIONER MACKINTOSH: Would your aim
4 produce really a sort of economic "State of the Union"
5 speech once a year accompanied by a supporting white
6 paper and separate from the budget?

7 PROFESSOR NEUFELD: Yes, I would think
8 that I would find that quite satisfactory.

9 COMMISSIONER MACKINTOSH: There is this
10 problem of making public documents from civil servants
11 to ministers, which I understand are ordinarily
12 privileged documents and, as I say, I would be
13 afraid that they would be too timid and water the
14 thing down?

15 PROFESSOR NEUFELD: I would be afraid of
16 that, too; I would think for one thing that the
17 flow of documents from the board to the government
18 would nonetheless be there and that all that
19 information would be privileged and wouldn't be
20 revealed to the public, but that in the end it would
21 be useful for this organization to give some public
22 evidence of the areas in which it has been working,
23 But I must say while this is true, that it would
24 have to have the support of the ministers and that
25 therefore the minister might delete certain sections
26 from it, in the end it is better to do that
27 than pretend in a system of responsible government
28 that we can have boards or committees that are
29 not responsible.

30 COMMISSIONER MACKINTOSH: There was, in fact,



1 during the wartime a committee that had some of this
2 type of responsibility, but its reports were not public.

3 THE CHAIRMAN: Well, I think that it may
4 be common practice in certain areas of government
5 to have inter-departmental committees set up of
6 one kind and another, in which they might bring
7 in outsiders for certain reasons, in view of certain
8 problems, and sit down with the ministers involved.
9 The provincial government used to do it through
10 the Treasury Board; they would sit for hours and
11 days, and this is the same sort of thing as you have
12 in mind, but there was no formality about the form
13 of the committee because it changes its personnel
14 from time to time, of course, when there are different
15 problems and the decision was always the government's
16 decision but it would come out as a decision of
17 the Treasury Board; it was the decision of the
18 government always, but it served a very useful
19 purpose and I would think in the sort of problems
20 we have to deal with here that something of that
21 kind -- if it doesn't now exist -- might serve a
22 purpose.

23 PROFESSOR NEUFELD: I think that I am
24 biased in favour of some sort of permanent arrangement
25 because I think these problems of growth and employment
26 and prices are permanent problems; they are very
27 important for the health of the nation and therefore
28 I think they justify the attention of some people
29 all the time.

30 It is true that this sort of arrangement



1 should be very flexible in the sense that outside
2 economists might become members of this research
3 group for limited periods of time. In the United
4 Kingdom it is not at all unusual for outside
5 academics to become part of the civil service for
6 one or two or three or four years, and I would hope
7 that the very same thing could happen here. I don't
8 think that this would conflict with the principle
9 of secrecy because the arrangement would be that for that
10 time they, in fact, would become civil servants.

11 COMMISSIONER MACKINTOSH: On another
12 point you urge two separate changes, to some degree;
13 namely, that the Bank of Canada be brought closer
14 to the government through making it clear that
15 the Minister of Finance is responsible for all aspects
16 of economic stabilization, and that the Governor
17 of the Bank is subject to his direction.

18 On the other hand, you want to orient
19 the bank more completely towards the markets. It
20 is to some degree moving in opposite directions at
21 once. We get criticisms that the bank is too close
22 to the government, being located in Ottawa, and
23 being too far from the market.

24 PROFESSOR NEUFELD: Well, I think that
25 there really isn't a contradiction between these two
26 views because I would think that the arrangement
27 should be that the government is always
28 responsible for policy, but the government
29 should not interfere with the operations of the
30 Bank of Canada.



1 I think that the physical separation of
2 the central bank from the financial markets has
3 been, in part, responsible for the separation between
4 the bank as a market operator and the market in
5 general.

6 I think that the separation between government
7 and bank has arisen, or did arise in the past, because
8 it was not made clear who, indeed, was responsible
9 for monetary policy.

10 I think that the disadvantages of physical
11 separation can be overcome even though no one is
12 left with any doubt that in the end the broad
13 policy followed by the central bank is the policy
14 of the government of the day.

15 I have recognized the problem in this
16 sense, that I think if the Bank of Canada became
17 a department of government it could not really
18 develop into a truly market oriented institution.
19 But I think that as long as it is a separate entity
20 the chances are greater that, indeed,
21 it will continue to develop into a market-oriented
22 institution.

23 COMMISSIONER GIBSON: Do you not
24 think that making the central bank subject directly
25 to the Minister of Finance might have the effect
26 of reducing, etc., status and initiative?

27 PROFESSOR NEUFELD: My view is and has
28 been for some time that the status of the bank,
29 the prestige of the bank hinges in part on its
30 enjoying firm support from the government of the day.



1 The argument is sometimes made that the prestige
2 of the bank is higher if it is thought to be independent
3 of government. I would disagree. I think that the
4 position of authority of the bank will be enhanced
5 if it is clear that central bank policy has behind
6 it the full force of government support.

7 However, that doesn't really worry me too much.
8 In part, of course, it would depend on what kind of
9 directives we issue; if the directives became very
10 frequent and very detailed or if they, for example,
11 related to the amount of bonds that the Bank of
12 Canada and the kind of issues that the Bank of
13 Canada should sell this week and next week, then
14 I would think that the prestige of the Bank of
15 Canada would most certainly suffer.

16 On the other hand, if the directives were
17 clearly seen to be a technique to be used only in
18 the most unusual circumstances, then I don't think
19 they would cause the position and the
20 prestige of the Bank of Canada to be compromised.

21 Now, I do think that whenever a major
22 conflict arises the central bank necessarily
23 does suffer in some respects. I think that the
24 central bank did suffer in its prestige in the last
25 year or two. I can't see any way of avoiding that.
26 I think once there is a basic conflict the people
27 that are involved in the conflict are bound to
28 suffer. I don't think this is because there is a
29 directive; it is because the conflict has arisen.

30 COMMISSIONER GIBSON: Such conflicts are rare,



1 wouldn't you agree with that?

2 PROFESSOR NEUFELD: I would hope they would
3 never arise.

4 COMMISSIONER GIBSON: The thing about the
5 directive is that you do alter the power of
6 the Banks. Even if the directive is never used
7 there is a power in the background?

8 PROFESSOR NEUFELD: Well, I think it is
9 a clearly defined power, There is power now in
10 the background.

11 COMMISSIONER GIBSON: Yes there is, and that
12 is really why I am asking this question; that ultimately
13 as it increases its requirements this must prevail?

14 PROFESSOR NEUFELD: Yes. I think that the
15 thing to be said for a directive is that it would be
16 a cleaner way of reacting to a conflict than the
17 way it was reacted to in the past. It doesn't alter
18 the fact that even at present the power of government
19 is supreme. I agree it is supreme, but I think
20 it is a tidier way of handling the conflict.

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1 COMMISSIONER GIBSON: Do you think that
2 conflicts should be handled in a tidy way?

3 PROFESSOR NEUFELD: I think it would be
4 just as well not to make them more untidy than
5 necessary.

6 THE CHAIRMAN: Well, is there not a danger
7 in having everything spelled out in legislation?
8 Does that not put the bank in the position of being
9 sort of at the beck and call of government? You get
10 a note from the government directing the bank to
11 do something and the bank either must do it or the
12 governor must resign if he does not agree with it.
13 Is that the way to deal with problems of this kind?
14 Is not the bank function more than just doing what
15 the government thinks it ought to do? Has not the
16 Bank of Canada a mind of its own as to its sphere
17 of responsibility, and if the government puts what
18 the bank thinks is undue pressure upon it to do the
19 wrong thing, is it not up to the bank to show some
20 signs of resistance, and should it not have a certain
21 amount, at any rate, of resisting power? If all
22 that is required is a directive from the government
23 and the bank has to throw up its hands and say: That
24 is what the government told us to do so we do it, you
25 lose the advantage of something which is of very
26 great value in the whole financial system. A bank
27 that has a great degree of independence and has
28 prestige as a result of that, this means something
29 in the minds of the people, as a result the government
30 must be very careful before it attempts to use some



1 undue pressure upon the bank for some ulterior motive
2 of its own which may be unconnected with the real
3 problem involved.

4 PROFESSOR NEUFELD: I think you have probably
5 stated my sentiments better than I could have stated
6 them myself. This is why I thought it was necessary
7 to construct some obstacles in the way of interference
8 from government, and the obstacle which I had in mind
9 was the effect of the resignation of the Governor and
10 an arrangement whereby the Governor could be heard
11 if he feels he must resign his position. I know I
12 am out of step on this score with some economists who
13 think that government is responsible and, therefore,
14 should issue whatever directives it wants to issue,
15 and that the central bank should really have no
16 position of authority or independence at all. But
17 I think that if one views the attitude of the public
18 toward matters of currency, toward safeguarding the
19 currency of the country and particularly since there
20 are numerous examples where political exigencies
21 have interfered with the soundness of the currency,
22 then I think it is useful to compromise on this
23 issue of government responsibility,
24 by putting some sort of buffer between the Bank of
25 Canada and the government. The buffer that I see
26 is the threat of the Governor's resignation and the
27 assurance that his views will be made known to the
28 public; so that if government wishes to push its point
29 on an issue of policy it must weigh the consequences
30 of the Governor's resignation / against whatever political



1 advantages it sees in its action.

2 THE CHAIRMAN: Yes, but the Bank of Canada
3 is constitutionally at least set up as a separate
4 entity from the government. It is true the government
5 has the final say. That has been established during
6 the last issue, and that was agreed upon by all parties
7 eventually. The precedent has been established that
8 the government has the final say when there is a
9 fundamental difference of opinion, so that why do
10 you need anything further so that the matter will be
11 spelled out in a statute or in some written form?
12 Shouldn't it be left more or less elastic, giving the
13 bank greater prestige and powers to exert itself with
14 a little more force behind its views? I think the
15 bank should be considerably strengthened, and once
16 you have it all elaborately set forth and some issue
17 arises which is not quite covered by all the writing
18 that has been put on paper, then you get in to further
19 vagaries of dispute of an irrelevant nature.

20 PROFESSOR NEUFELD: What worries me is
21 that peoples' memories are incredibly short. In 1941
22 Mr. Ilesley, when he was minister of finance, spelled
23 out very clearly the position of the Bank of Canada
24 in relation to the government, and had all subsequent
25 ministers of finance read that particular statement
26 in the House of Commons I think some of the difficulties
27 of the past several years would have been avoided.
28 This view that the government is responsible for policy
29 was stated by ministers of finance even after Mr.
30 Ilesley, but I think one does have to remember that



1 occasionally ministers of finance are not entirely
2 aware of the subtleties of precedence, and in all
3 innocence are led into a position which they would
4 not have been led into had they indeed been fully
5 aware of their position vis-a-vis the Bank of Canada.

6 I think that the matter of
7 giving the Minister of Finance the power to issue
8 directives is merely a way of formalizing what in
9 fact is the case, but what is sometimes forgotten.

10 COMMISSIONER MACKINTOSH: Returning to
11 the question of the relationship to markets, I
12 really have no criticism of the proposals or possibilities
13 you suggest at the bottom of page 19 and carrying on
14 to page 20, except that in practice they are awfully
15 difficult to accomplish in terms of careers, and in
16 terms of income, and in the case of the Board of the
17 Bank of Canada, in terms of other than conflicting
18 directorship which may be held. You suggest in
19 number 4 there a permanent advisory board drawn from
20 financial institutions. Do you think that is better
21 than the Governor of the Bank of Canada making it
22 a responsibility to have periodic discussions with
23 each of these groups, among the financial institutions?

24 PROFESSOR NEUFELD: I do not think it is
25 better. I think that in all of these suggestions
26 my reaction really is, I wish all these suggestions
27 were not necessary; I wish this had been done in the
28 past; I wish there was this focus of attention of
29 the government, concentrated attention, on
30 the great issues of economic policy; I wish the Bank



1 of Canada would on all occasions have given the impression
2 of drawing whatever advice it could draw from the capital
3 market, and so on. I think that it is only because
4 I see that these things have not been done on a con-
5 sistent basis that the need to think in terms of some
6 formalization of desirable procedures arises. I do
7 not regard it as an inherently superior way of doing it.
8 There is the danger that in the environment of a crisis,
9 and in the environment of controversial issues, a
10 certain degree of co-operation may develop, but it
11 will vanish as soon as the crisis disappears and the
12 events change.

13 COMMISSIONER MACKINTOSH: That is all
14 I have.

15 COMMISSIONER BROWN: There is one question
16 I should like to ask about that, and that is in
17 respect of the suggestion that the Governor be at
18 the pleasure of the Governor-in-Council. This puts
19 him in a fairly junior status as compared to some
20 other government officers, and how difficult is it
21 going to be to get the kind of man we really want to
22 be Governor when he has to operate under this sort
23 of tenure of office in spite of the fact that if they
24 do fire him he can appear before parliament?

25 PROFESSOR NEUFELD: Well, I think that again
26 what I am thinking of is to have an arrangement which
27 would be useful in unusual circumstances. Ordinarily
28 I would say that the Governor's term should be fixed
29 for a certain number of years, but under unusual
30 circumstances in effect he can be asked to leave at the



1 pleasure of the Governor-in-Council. My reasons for
2 taking that view are several in number.

3 First, I think that monetary policy is
4 far too important to be left for a number of years
5 in the hands of someone who might turn out not to be
6 a good central banker. He may be as honest as one
7 would wish, and as well-intentioned as one would wish,
8 but all things considered he might not be a good
9 central banker. I think it would be unfortunate because
10 the issues are too great; the stakes are too big, in
11 this country, to have an incompetent central banker
12 at the head of a bank for five or six years simply
13 because he has behaved himself in a sort of moral
14 sense of the word.

15 COMMISSIONER BROWN: Well, I was wondering
16 why you would do this at the pleasure of the Governor-
17 in-Council instead of on address by the Senate and
18 the House of Commons. You see, in spite of the fact
19 that he would be given the opportunity to appear, and
20 so forth, would this mean that he could be gotten rid
21 of the day after parliament prorogued, and that would
22 be that, wouldn't it, until the next parliament
23 assembled?

24 PROFESSOR NEUFELD: Are you asking me
25 whether I am worried that there might be a delay
26 between the time that he is removed and the time
27 that he is heard?

28 COMMISSIONER BROWN: Yes. I am wondering
29 if you are not making it a little too simple for the
30 government to get rid of him without there being an



1 opportunity for public discussion.

2 PROFESSOR NEUFELD: It might be that it
3 would be desirable for him to be heard immediately. There
4 is certainly no reason why he could not be heard in
5 public before that. He would not be prohibited
6 from making statements to the press before that,
7 explaining his position. I think that to be given
8 the opportunity to state his case in the official
9 records is desirable.

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12 I do not think that the delay in hearing him before
13 the committees of parliament would really be a very
14 great disadvantage. In fact, I would think that any
15 government that faced this possibility would wish to
16 get rid of it as soon as possible; would wish to
17 get rid of the problem as soon as possible.

18 If they remove the Governor and the Governor has
19 six months to talk to the public about it and then they
20 have to face him again when parliament reconvenes is
21 not something that ^{they} / would regard, I think, as an
22 advantage.

23 COMMISSIONER BROWN: I just wanted your
24 points of view on that.

25 What I should like to ask you now about
26 is that in your suggestions about fiscal weapons you
27 talk about variable depreciation allowances, and
28 also direct controls on consumer spending, and particularly
29 the variation of down payments and periods of repayment
30 requirements. I was wondering if you had any new ideas



1 on this very difficult problem of controlling down
2 payments.

3 PROFESSOR NEWFELD: The difficulties are
4 first of all of a technical kind and secondly a
5 constitutional kind. Both difficulties are great.
6 I suspect that the constitutional difficulties may
7 in the end be met only through the co-operation of
8 the provinces. I am not as pessimistic over the
9 possibilities of such co-operation as some other
10 people are, particularly since one does hear more
11 frequently now than used to be the case the suggestion
12 that provinces to some extent are considering the
13 general welfare when they arrange their budgets.
14 So that co-operation in that direction might be
15 possible.

16 As to the technical problems of restricting
17 contracts of the many hundreds of individual institutions
18 that make them, I would hope that
19 this could be overcome by making whatever provisions
20 are made very, very simple. It might even be that
21 down payment requirements would have to be foregone
22 and that the requirement in the end is based entirely
23 on the length of repayment, I don't know. I admit
24 that the technical problems are great and that to over-
25 come them and to overcome the constitutional problems,
26 would require the co-operation of the pro-
27 vinces unless, of course, it could be made to come under
28 the general area of interest rates and federal
29 responsibility for interest rates.

30 COMMISSIONER BROWN: In your flexible variation



1 of depreciation allowances and capital cost allowances
2 you visualize the absolute cost or merely the cost
3 of money on the cash flow that is referred to? 'You
4 mention something about varying the total amount that
5 could be written off. Are you visualizing cases
6 where you would not permit the complete depreciation
7 over a period of time, or perhaps even periods when
8 you permit more than 100 per cent depreciation?

9 PROFESSOR NEUFELD: I do not think that that
10 degree of swing in the use of the technique should be
11 precluded. I admit what I am really doing is talking
12 in terms of corporation income tax. This is one way
13 of changing corporate income taxes. There are other
14 ways; a tax on investment, as the Swedes have done
15 some times, on some occasions. I suspect that the
16 advantage of doing it this way; that is to change
17 the corporation income tax rate this way rather than
18 through a general change in corporation income tax
19 is that it focuses attention specifically on those
20 corporations that are engaging in investment activity
21 and capital spending, and if capital spending becomes
22 excessive this kind of selective control may become
23 desirable. I think that it should be possible for
24 some corporations during periods of severe recession
25 to write off even more than 100 per cent of their
26 capital expenditures, if this seems sensible from
27 an economic point of view, and during other periods
28 to write off less than that.

29 It is true that what this would do, I
30 would hope, would be to change the timing of the starts



1 of projects. I think that is essential. We never
2 really want to stop projects dead in their tracks,
3 but we really want them to delay those projects
4 a year or two years.

5 COMMISSIONER BROWN: What do you think
6 of the Swedish investment allowances?

7 PROFESSOR NEUFELD: That is another
8 technique I think that in the end would serve the
9 very same purpose, which would be to postpone invest-
10 ment decisions.

11 COMMISSIONER MACKINTOSH: But with rather
12 more power in it than the variable depreciation one?

13 PROFESSOR NEUFELD: It appears that it
14 does have more power in it, and I think that administration
15 might in the end decide which of these various techniques,
16 which are really techniques of the same kind, with
17 some variation between them, in fact would be used.
18 I would simply emphasize that I think that the record
19 suggests that some one of these techniques will on
20 occasion have to be used.

21 COMMISSIONER BROWN: One other point I
22 should like to ask you about and that is in respect
23 of these statistics on labour productivity and product
24 prices which you would wish to be developed by an
25 economic stabilization board. Would you tell us
26 whether your thought is that this would be purely
27 advisory, or would it have some sanctions behind it?
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1 PROFESSOR NEUFELD: It is difficult to
2 conceive of sanctions being applied. For one thing,
3 our statistical information would have to be rather
4 better than it now is to warrant basing sanctions
5 on it. However, I do think that the factors that are
6 now being considered when wage settlements are made,
7 and the arguments now being used, are frequently
8 quite extraneous to the problem of whether wage
9 increases are, in an economic sense, really
10 justified. The arbitration boards and the decisions
11 of them are so often, to my mind, made without
12 the economic considerations that should have been
13 involved in the final settlement. I do not think
14 the statistics are very good in this respect but,
15 on the other hand, this does not deny that the
16 final settlement should ideally reflect the
17 economic things which it is difficult to measure
18 rather than the ^{non} economic things which should not
19 be considered really at all.

20 COMMISSIONER BROWN: I have heard it
21 suggested that we have so many varieties of
22 statistics that both sides could find suitable
23 statistics to justify their own point of view.

24 PROFESSOR NEUFELD: I think there is a
25 variety of statistics and a variety of economists,
26 and this, therefore, poses a problem. I would hope,
27 if this group, as a result of the quality of its
28 work, would acquire a certain prestige that its
29 views would be very carefully considered and that
30 it would be very difficult for one or other side



1 of the bargaining table to dispute their findings.
2 At least both sides of the table would then, I hope,
3 be working with those statistics which this outside
4 and independent group of people would regard as
5 least imperfect.

6 COMMISSIONER LEMAN: Professor Neufeld,
7 at page 21 you discuss the floating bank rate, and
8 one must note that you wrote and dated this brief
9 on May 17th, 1962. The fact that the bank has
10 come back to a fixed bank rate rather than a floating
11 one would seem to encourage no discussion on this
12 point at all, but I would still like to ask you
13 a couple of little questions about it.

14 Don't you think that this matter of
15 signals and the interpretation that the street,
16 or even the university economists, can make of these
17 can be over-stated a bit?

18 PROFESSOR NEUFELD: Well, I regard bank
19 rate as a remarkably flexible technique in the sense
20 that it can mean different things on different
21 occasions. It is quite clear on some occasions
22 that the move of a bank rate is merely a move which
23 confirms what has already happened. Also, the
24 discussion in the press, together with the statement
25 accompanying the move by the central bank, will
26 very quickly make it clear what the significance
27 of that move is. On other occasions a different
28 kind of bank rate move -- perhaps a very sudden one
29 and a very unexpected one, one that is somewhat
30 larger than might have been expected -- will create



1 a quite different impression of the significance
2 of the bank rate. So, I would say the bank rate
3 can be used in an exceedingly flexible fashion under
4 varying economic circumstances, and that there will
5 be very little confusion as to its significance
6 because of the discussion that will surround the
7 move itself. I think it is a mistake to assume
8 that this once-for-all move in a rate is a blunt
9 instrument. It is an instrument which affects
10 expectations; it is an instrument which generates
11 discussion and will make clear, usually, what is in
12 the mind of the central bank. Also, it is an instrument
13 that can begin to make, under certain circumstances,
14 interest rates move well before this would have been
15 possible through the more ponderous route
16 of cash management and money supply. On some
17 occasions it is possible to move interest rates and
18 then take ones time about enforcing this move through
19 the use of monetary expansion or contraction,
20 whichever it may be.

21 COMMISSIONER LEMAN: In your explanation
22 I thought you had just told us that the movement
23 in the fixed bank rate, in the administered bank
24 rate, can mean different things at different times:
25 doesn't it follow that unless the observer is
26 particularly wise he can misinterpret its significance
27 at that particular moment?

28 PROFESSOR NEUFELD: I think that the people
29 who are directly affected first are the people in
30 the market, and my impression of these people is that



1 when a thing like that happens they are very anxious
2 to find out what really it does mean. Through their
3 discussion with traders and through careful reading
4 of the official announcement it does not take very
5 long for them to decide what it does mean. So, I
6 don't think that different people will interpret it
7 differently -- that is, among those people who are
8 directly concerned. I think it may be more the case
9 if you move beyond the fringe of the financial people
10 where it might be interpreted differently. Also,
11 however, I think the consequences of it for a time
12 not being correctly interpreted^{by them}/are not as great
13 as if this happened among financial people.

14 COMMISSIONER LEMAN: Let me use another
15 approach to the same question: do you think it may
16 mean too much in England-- it is too automatic in
17 its effect?

18 PROFESSOR NEUFELD: What I do not like
19 about the English bank rate is that I think it moves
20 interest rates in much too rigid a fashion; there
21 are all kinds of interest rates tied to it. I think,
22 while there are some advantages, there are some
23 disadvantages in that, but I think that in terms
24 of its influencing expectations that it is used
25 as effectively and as well as it should be used in
26 the United Kingdom. I might add they have used it
27 when they have had balance of payments problems,
28 and I think to fairly good effect, if one does not
29 expect too much from it. Now, with a fixed exchange
30 rate in Canada, we may find we will have to use it too



1 for balance of payments problems on occasions.

2 ~~... ..~~ If we did not have a
3 fixed bank rate, and if we relied substantially on
4 interest rates to protect the fixed exchange rate,
5 I am not sure how the Bank of Canada could control
6 it. If the fixed bank rate was desirable before
7 we had a fixed exchange rate, I think it is doubly
8 desirable now that we have a fixed exchange rate.

9 COMMISSIONER LEMAN: Do you think there
10 can be at times -- perhaps rarely -- technical
11 positions that develop of a very, very short-term
12 nature in which the bank would not want the usual
13 interpretation put on an upward movement, or a
14 downward movement -- that this had developed from
15 a very technical sort of position, and the bank
16 does not want it to have this pervasive effect
17 which could not be reversed very fast?

18 PROFESSOR NEUFELD: I think under those
19 conditions the bank rate would be a very effective
20 technique in that it just would not be moved. The
21 very fact it was not moved would, I think, have a
22 very salutary effect on expectations in the market.
23 This raises the possibility that bill rates might
24 move well above bank rate, as occasionally happens
25 in the United States. This does not frighten me
26 too much because I think the Bank of Canada should
27 in no sense regard bank rate as the price of bank
28 cash. I think when the Bank of Canada decides it
29 will or will not lend money, this should be quite
30 unrelated to the level of bank rate. Indeed, the



1 Bank of Canada already recognizes this, if I understand
2 its operations correctly, in the sense that a chartered
3 bank has got to borrow for a week; it cannot borrow
4 for a shorter period. Also, if it wishes to borrow
5 more frequently than a certain number of times
6 in a month, it has to borrow at a rate higher than
7 the bank rate. Dealers always borrow at bank
8 rate. I think it should be the prerogative of
9 the Bank of Canada to lend money at the rate at which
10 it wishes to lend money. So, I do not regard the
11 possibility of short-term money market rates going
12 through bank rate as a limitation of the device,
13 because I think the actual bank cash should be
14 rationed in a way which the Bank of Canada considers
15 appropriate, quite apart from the level of bank
16 rate.

17 COMMISSIONER BROWN: Did I hear you say
18 that dealers borrow at bank rate?

19 PROFESSOR NEUFELD: It is a good point,
20 in the sense that at present dealers borrow at
21 the bank rate as previously defined.

22 COMMISSIONER BROWN: Do you mean
23 we are on a double system?

24 PROFESSOR NEUFELD: Yes, and it is question-
25 able whether we should be.

26 COMMISSIONER BROWN: This was the point
27 I wanted to clear. I thought I heard you say they
28 borrowed at bank rate.

29 COMMISSIONER LEMAN: In a sense, that
30 is a reflection of what Professor Neufeld just said,



1 that the bank should be entitled to loan at whatever
2 interest it feels it should loan.

3 PROFESSOR NEUFELD: I think, simply, one
4 should not regard bank rate as a price for getting
5 bank cash. Bank cash should be made available by
6 the Bank of Canada having in mind what it wants
7 to do with the supply of money, and if one looks
8 at bank rate as not being the price of bank cash,
9 then I think it does not matter whether bank rate
10 is below or above the bill rate for a short period
11 of time.

12 On this other question, I am not sure
13 whether you wanted me to comment on whether the
14 dealers get a preferred rate at the present time;
15 that is, where we have two rates -- one at which
16 the dealers can borrow and one at which the chartered
17 banks can borrow. I think, first of all, if the
18 Bank of Canada wishes to maintain its definition of
19 bank rate -- that is, the minimum rate at which
20 money can be borrowed from the Bank of Canada -- that
21 it should now choose a different arrangement, because
22 while it is argued that purchase resale agreements
23 are not loans from the Bank of Canada, it would
24 be difficult to convince me/they are not loans.
25 I don't feel strongly about the arrangement, except that
26 we must realize it reduces the/effect on interest rates, and
27 if under certain circumstances one would wish to
28 have the maximum effect from movements in the fixed
29 bank rate, then this is not the most desirable
30 arrangement.



1 COMMISSIONER GIBSON: In this particular
2 context would you care to say a little more about
3 the disadvantages of the United Kingdom system whereby
4 a lot of the interest rate structure moves with the
5 bank rate?

6 PROFESSOR NEUFELD: I think that the
7 disadvantages lie in that it permits or, at least,
8 it encourages the various institutions to look only
9 at bank rate when deciding the price at which they
10 should make credit available. I would hope there
11 would be sufficient competition between various
12 types of institutions that they can vary their own
13 lending and borrowing rates and meet competition,
14 rigid
and not be in/harmony with the bank. I think the
15 arrangement imposes a rigidity which is not necessary.

16 COMMISSIONER GIBSON: It does produce
17 a pretty big response, though?

18 PROFESSOR NEUFELD: Yes, and this does not
19 suggest we in Canada have been without rigidities
20 in institutional rates. I think the chartered banks'
21 prime loan rate has been a fairly rigid kind of rate
22 over the post-war years and before that. I would
23 hope that as bank rate is used more and more we
24 would find that while there is not a rigid relationship
25 between bank rates and institutional rates, there
26 is a general relationship between them and that
27 the timing of changes in institutional rates would
28 begin to move more in sympathy with rates in the
29 market and bank rate than has been the case in the
30 past.



1 THE CHAIRMAN: We will continue. Mr. Leman?

2 COMMISSIONER LEMAN: Professor Neufeld,
3 we were talking about the bank rate and apparently
4 the importance you attach to it, which is not very
5 great; you say so in your memo, that you don't
6 consider it one of the primary considerations where
7 you felt that improvement was needed, but you do
8 therefore regard it just as a signal. Now, is there
9 more that you would like to say about signals and
10 their role in improving the system?

11 PROFESSOR NEUFELD: Is your question do
12 I think there are other techniques which could be used
13 in this way, signal techniques?

14 COMMISSIONER LEMAN: Yes.

15 PROFESSOR NEUFELD: I don't think so, because
16 I think that it might be confusing to have more than
17 one signal. I would think that regardless of what
18 signal one in the end chooses, there should only
19 be one.

20 The bank rate happens to serve that
21 purpose reasonably well; it is not the only signal
22 one can imagine, but I think that it is satisfactory
23 and I think also it is the signal which is most
24 easily understood. There are other kinds of signals
25 which might be less easily understood. It is a signal
26 that is simple, direct, and it receives a good deal
27 of publicity, and in some sense it is understood
28 by a great number of people and therefore I don't
29 think that we require any other signals.

30 COMMISSIONER LEMAN: Well, for instance,



1 do you like a governor that talks a lot outside of
2 his annual report?

3 PROFESSOR NEUFELD: I think it depends
4 in part on what he is talking about!

5 I think that by and large I like a governor
6 who talks as much about central banking as seems
7 useful and I think that there has been an aura of
8 mystery surrounding central banks and central
9 bank governors which is difficult to justify. I
10 therefore think that the duty of the central bank
11 and of the governor is to be as forthcoming as
12 is at all possible, I think that this will
13 make his problems less difficult and it will encourage
14 an understanding of the problems he faces and therefore
15 it will encourage the support of public opinion
16 for the sometimes distasteful policies he might have
17 to follow. I think central bankers
18 should not be confined to their annual report in
19 making statements, and I wouldn't prescribe any limits on
20 the kind of speeches that he makes, but I think
21 that all things being equal it would be highly
22 desirable for him to make speeches which make his
23 current policy more understandable to the general
24 public.

25 COMMISSIONER LEMAN: Unless someone
26 wants to ask any more questions on this subject,
27 I would like to jump to the next point which you
28 take up in your brief at page 23, and that is your
29 recommendation that the 6 per cent ceiling on
30 chartered bank loan rates be removed.



1 On that score there are two questions I
2 would like to ask you . One is do you believe that
3 by doing this you would substantially reduce the
4 amount of rationing of credit that would have to
5 be done at times of tight money?

6 PROFESSOR NEUFELD: I think you would
7 reduce the amount of rationing. I think there is
8 a natural tendency for reasons of simplicity,
9 perhaps, -- and perhaps in part for reasons of
10 competition -- for chartered bank interest rates
11 and commercial bank interest rates to be fairly
12 uniform.

13 I think that what would happen is that
14 the changes in interest rates charged by chartered
15 banks would be more in harmony with the state of
16 the capital market than has been the case in the
17 past; therefore, I think that it would not remove
18 all rationing. I suspect that there would still be
19 rationing because there is a tendency for bank
20 rates to be fairly simple and fairly few in number,
21 but it would reduce it to some extent; but I think
22 it would improve the timing of the changes in these
23 interest rates.

24 COMMISSIONER LEMAN: Is that another way
25 of saying that you believe that perhaps it would
26 increase a bit the area of competition between
27 the banks and bring it out a little bit more in the
28 interest rate area than it has been?

29 PROFESSOR NEUFELD: I think it would
30 increase the competition between banks in the area



1 of the price of the commodity that they sell, and
2 that such increased competition is much to be desired.
3 I don't think that this would mean that we would
4 have different interest rates at different banks;
5 I think what it would mean is that ---

6 COMMISSIONER LEMAN: It wouldn't last very
7 long.

8 PROFESSOR NEUFELD: It wouldn't last very
9 long, and I think it would mean that the timing of
10 changes in interest rates would be different, and
11 different in the sense that it would make them more
12 appropriate for purposes of economic stabilization.

13 COMMISSIONER LEMAN: You feel that the
14 ceiling does tend to bring people up towards it
15 and introduces a kind of greater feeling of security --
16 and I mean security here in the competitive sense --
17 than a completely open range?

18 PROFESSOR NEUFELD: I think that one of
19 the undesirable effects of the ceiling is that there
20 are times when bank interest rates are not as high
21 as they should be, and that because banks feel that
22 they may have not maximized their return on loans
23 during these periods, it inhibits them from making
24 them low when they should be low. This influences
25 them in the extent to which they can offer attractive
26 interest rates to savers and encourages the
27 savers to move out of bank deposits into other
28 things which are more flexible in the rate of
29 return that they provide. I think it is this kind
30 of rigidity that exists in the fixed loan rate.



1 COMMISSIONER LEMAN: Do you believe that
2 it would tend to increase the spread of rates, say,
3 between the prime rate and the unprime rate, and
4 that sort of thing?

5 PROFESSOR NEUFELD: I think it certainly
6 would, and it should increase the spread between the
7 prime rate and the normal interest rate.

8 There have been times, as we know, when
9 the difference between the prime rate and the 6 per cent
10 rate has been zero. This really doesn't make any
11 sense at all to my mind; it simply is true that
12 there are different credit ratings, and that different
13 borrowers should be borrowing at different rates
14 of interest. I think also this probably means that
15 even the prime loan rate is less flexible than it
16 should be, because if it cannot go through 6, the
17 chances are it will not fall very much when interest
18 rates fall.

19 COMMISSIONER LEMAN: So you believe the
20 result is that a non-class A borrower would still
21 get his money but he would have to pay a little more
22 for it?

23 PROFESSOR NEUFELD: He would have a better
24 chance; the same borrowers would have a good deal
25 better chance of obtaining funds than they now have.

26 I think that the inevitable result of
27 rationing is to supply funds to the most credit-worthy
28 borrower, and this is in contrast to the case under
29 flexible rates where the bank manager, I think, would
30 pay more attention to the fact that while he may be



1 giving something away in terms of credit-worthiness,
2 he is also getting a one or one and one-half per cent
3 higher rate of return on his loans, and therefore
4 I think it would really put certain classes of
5 borrowers in a better position. Also, I think it
6 might well be argued it would result in a better
7 allocation of the loan funds, because the chap who
8 expects a high rate of return on his loan -- which
9 in turn reflects the high productivity in the operation
10 he is engaged in -- might be precluded under a fixed
11 chartered bank loan rate from obtaining funds, and
12 the funds would go to someone whose productivity
13 and contribution to the nation's output would be
14 somewhat less.

15 COMMISSIONER LEMAN: In your brief you
16 don't go beyond this recommendation regarding the
17 ceiling. Would you remove other impediments in
18 the way of banks? Would you broaden even more their
19 loaning powers in different areas of loaning?

20 PROFESSOR NEUFELD: I think that because
21 of the combination of savings banks and commercial
22 banks all in one organization, the Canadian chartered
23 banks are financially so strong that they could be
24 given almost any freedom that one wishes to give
25 them with respect to the type of investments that
26 they could make. My general impression is that
27 the bias and prejudice relating to where banks
28 should or should not loan money is based on a period
29 in history which will nevermore return, and therefore
30 I would not at all feel unhappy if the banks were



1 permitted complete freedom in the way they lend
2 their money.

3 COMMISSIONER LEMAN: This grew up at a
4 time when it was thought if you failed to get to them
5 that they would become the only lenders, is that
6 right?

7 PROFESSOR NEUFELD: Well, in part that
8 is true because they were the dominant institution
9 and I suppose still are to a degree, but they
10 certainly were.

11 During the period when the basic
12 characteristics of the Bank Act were being formed --
13 that is, before the turn of the century -- in those
14 times there were numerous examples why there should
15 be a restriction on the type of lending that the
16 bank should do. Occasionally they did get
17 involved in real estate ventures and there were
18 bank failures during that period, there were a
19 large number of little banks, over 50 of them in
20 the 1870's, but all of this has changed and we
21 now have very strong banks. We have the savings
22 side of their business developing much more than
23 was the case then and, indeed, I think their banking
24 practices, their techniques and methods for credit
25 appraisals are much more refined than was the case
26 then, and that is why I think that the decision
27 as to where they should lend their money should
28 be left almost entirely in their hands.

29 COMMISSIONER LEMAN: That is all I have
30 on that section.



1 COMMISSIONER MACKINTOSH: I would like
2 to ask a question that follows on from that, where
3 you speak of the non-bank financial intermediaries,
4 and you express the judgment that the present
5 techniques for controlling monetary expansion worked
6 satisfactorily and with satisfactory promptness
7 also on the near banks. Is this based on particular
8 evidence, or is this just an impression?

9 PROFESSOR NEUFELD: It is an impression
10 based on the evidence which I have been able to find
11 on the matter.

12 I would say that my view is in part based
13 on the fact that I think the incidence of rapid
14 rates of growth of non-bank financial intermediaries
15 can be explained first of all by what I would call
16 "once and for all" innovations in the capital market
17 and, secondly, by these particular institutions
18 catering to a borrower that happens to be somewhat
19 insensitive to interest rates, and I don't think it
20 is because these institutions are so much like
21 banks that they can obtain unlimited amounts of
22 funds at low cost.

23 In other words, I think that in most cases
24 the growth of these non-banks is not very volatile;
25 that their profit position will be affected by
26 changing interest rates, and that in a few cases
27 and in the post-war period this would include the
28 credit unions, the instalment finance companies and
29 the small loan companies, their
30 high growth is explained first because of the rapid



1 rate and the "once and for all" growth in consumer
2 credit as such, and this complete new field developed
3 over a few years, and also because some of these
4 companies were catering to borrowers who were not
5 very interest sensitive. I think that once these
6 innovations have been digested, and I think there
7 is every evidence that in the field of consumer
8 credit they have been very substantially digested
9 now, the rate of growth will be very different
10 than it has been in the past.

11 COMMISSIONER MACKINTOSH: What about
12 their attracting deposits away from the chartered
13 banks?

14 PROFESSOR NEUFELD: Well, of course,
15 in the short-run they don't really attract deposits
16 away from the chartered banks, but in the long-run
17 they certainly do, because what constitutes an
18 appropriate money supply will in the long-run depend
19 on the amount of non-bank deposits as well as the
20 bank deposits in the country.

21 I don't think that their ability to
22 attract deposits away from banks is based on the
23 fact that they are non-banks. I think it may be
24 based in part because the bank's flexibility is
25 diminished by their limitations on what they are
26 permitted to charge, and therefore what they are
27 permitted to pay on savings' deposits, and in that
28 sense they have an advantage over banks, but I
29 don't think it is in the sense that the banks are
30 directly controlled and the non-banks are not directly



1 controlled by the central bank.

2 COMMISSIONER MACKINTOSH: You don't think
3 there is any need, then, for any innovation of
4 control in these sectors?

5 PROFESSOR NEUFELD: I think it raises the
6 question as to what is a bank and what is not a bank.

7 I think they have control over banks in
8 the sense of control over the money supply of the
9 country, and this is very essential whether we do
10 or do not have economic instability.

11 The more the non-banks really
12 become banks the more necessary it would be to
13 extend control to them, but it does raise the
14 whole issue as to whether they should really be
15 called banks or not.

16 COMMISSIONER MacKEEN: You would suggest
17 that the reserves, in the case of non-banks, should
18 be applied as they are to chartered banks?

19 PROFESSOR NEUFELD: I don't think that
20 they should be applied at present. My reason for
21 saying that is that I don't think they are yet
22 sufficiently banks to be controlled in that way.

23 Now, my view is that a bank is certainly
24 a financial intermediary, and that a financial
25 intermediary is a bank to the extent that it accepts
26 deposits and to the extent that these deposits are
27 used directly or indirectly as a medium of exchange;
28 directly in the sense that cheques can be written
29 against them, and indirectly in the sense that
30 they may be moved very freely into cash



1 or cheques or orders which are drawn against chequable
2 accounts, and the question really is do the non-banks
3 have deposits of this kind in sufficient size to
4 justify their being controlled.

5 Well, before I can really answer that
6 one, one has to make up ones mind in some sort
7 of an arbitrary fashion as to what is a bank deposit,
8 and I would think that the best criterion one can
9 use is the ratio of debits against deposits accounts
10 for a given period of time, the turn-over of the
11 deposits, and if over a 10-year period, or between
12 the Bank Act revisions, the turn-over of deposits,
13 say, in trust companies is of a certain size --
14 someone suggested one for one for a year, which is
15 as good a number as any -- then I would say one might
16 well consider putting cash ratio controls on these
17 kinds of deposits.

18 I think that one has to form a view first
19 of all as to how important these ^{"bank"} deposits are, in relation to
20 bank deposits deposited with the chartered banks,
21 and how important are they within a given ^{non-bank} institution.
22 I think both are in the end arbitrary judgments.
23 My own feeling is they are not yet sufficiently
24 important to justify the imposition of cash ratios
25 upon them.

26 COMMISSIONER MacKEEN: You take the very
27 heavy proportion of so-called hot money ---

28 PROFESSOR NEUFELD: Yes.

29 COMMISSIONER MacKEEN: --- which is probably
30 increasing as time goes on, and that man goes to where



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1 he can get the best interest rate and it wouldn't
2 be approved elsewhere and the banks are to some
3 degree precluded from catering to that market
4 and the rates get high and therefore it goes into
5 non-banks. Would you say that the proportion is
6 fairly heavy or enough to justify a reserve?



1 PROFESSOR NEUFELD: Well, I would rather
2 put the banks in a competitive position than
3 to impose additional controls on the non-banks.
4 I think if we remove the 6 per cent interest ceiling
5 the banks would have all the freedom that they would
6 wish in competing with the other banks for deposits,
7 and if that were done I do not think there would be
8 any need to do anything else. That is, as long as
9 these deposits outside the banks do not get too large
10 in relation to the total banking deposits in the
11 country.

12 COMMISSIONER MacKEEN: Well, there is a
13 statutory reserve of 8 per cent plus a so-called
14 voluntary reserve of something more than that.

15 PROFESSOR NEUFELD: Yes.

16 COMMISSIONER MacKEEN: Which takes away
17 from the liquidity of the bank?

18 PROFESSOR NEUFELD: Yes.

19 COMMISSIONER MacKEEN: And it has to be
20 maintained there?

21 PROFESSOR NEUFELD: Yes.

22 COMMISSIONER MacKEEN: Why would such a
23 thing be considered desirable in one case and not in
24 the other?

25 PROFESSOR NEUFELD: Well, I think it is
26 desirable in the case of the chartered banks because
27 their deposits are used extensively as a medium of
28 exchange; that is why the 8 per cent is required.
29 The additional 7 per cent I do not think is required
30 and I think should be removed. I think that the banks



1 are subjected to a degree of rigidity here which is
2 not necessary at all for effective monetary controls.
3 So again I would say instead of adding on rigidities;
4 instead of making the two equal by adding to the
5 rigidities of the non-bank institutions I would
6 reduce the rigidities that are imposed on chartered
7 banks. I do think the 8 per cent is, on balance,
8 desirable because it does make the central bank's task
9 more straightforward. It is not necessary in theory,
10 but the way things work out it does reduce variation
11 in cash for the purpose of controlling the supply of
12 money.

13 COMMISSIONER MacKEEN: Well, for all intents
14 and purposes there is a 15 per cent requirement now?

15 PROFESSOR NEUFELD: Yes, there is 15 per
16 cent secondary and cash reserve ratio. I would say
17 the 7 per cent ratio need not be there, and I think
18 it serves no useful purpose.

19 COMMISSIONER BROWN: In this same context
20 of removing the restrictions on the banks that do
21 not apply to the non banks, or putting the banks
22 in a position to be more competitive, would you
23 express a view on the possibility of having different
24 ratios for the different deposits; different types
25 of deposits for the chartered banks? In other words,
26 the savings deposits are the ones that are more akin
27 to the near bank deposits?

28 PROFESSOR NEUFELD: Yes.

29 COMMISSIONER BROWN: Say for the sake of
30 argument you reduce the ratio in respect of them and



1 increase the ratio in respect of current accounts, this
2 would mean the leverage factor might not be so great,
3 and it might give easier control. Would you give us
4 your opinion on this?

5 PROFESSOR NEUFELD: Yes. My view is that
6 in Canada because chequing is permitted against
7 savings accounts, and because there is some transfer
8 between the two during such times as the sales of
9 Canada Savings Bonds, for example, for practical
10 reasons it is better to have one cash ratio.

11 Now, if the banks said that because they
12 have such a high proportion of savings deposits that
13 they do not require an 8 per cent cash ratio, I would
14 be quite prepared to listen and say: Fine, if you
15 really think that is true we will reduce the ratio
16 to 6 per cent, because for the purpose of monetary
17 control I do not think it matters at all. One
18 could reduce it as much as one wished as long as it
19 remained reasonably stable at whatever level is chosen.
20 I think, not on theoretical grounds but simply
21 on grounds of simplicity, that I would prefer one
22 cash ratio, a cash ratio which, however, does already
23 take into account savings deposits and

24 the 8 per cent ratio already does take this into account.
25 If it does not, I would say lower it.

26 There was a period when it was 5 per cent
27 and the banks in effect on their own volition held
28 around 10 per cent. Then it was reduced to 8 per cent.
29 Since they of their own volition held 10 per cent, the
30



1 banks' view of reserves needed for carrying their
2 deposits was not very far away from the 8 per cent
3 view. So, personally, I doubt that the bankers would
4 argue -- they might, I don't know -- that 8 per cent
5 is not low enough; if they argued that it should be
6 lower, I think they should be listened to.

7 COMMISSIONER BROWN: I think the proportion
8 of savings accounts was less than it is now.

9 PROFESSOR NEUFELD: There may have been
10 some minor changes, although we have also reduced
11 the ratio to 8 from 10.

12
13 COMMISSIONER HARROLD: I notice you have
14 made some comment about the relationship between trust
15 companies and banks.

16 PROFESSOR NEUFELD: Yes.

17 COMMISSIONER HARROLD: Under present
18 conditions what do you say is the problem about these
19 links between the banks and the trust companies?

20 PROFESSOR NEUFELD: I think the problem
21 arises from the changing character of trust companies
22 in Canada. Trust companies in many respects are
23 acquiring the attributes of banks in this sense, that
24 they now openly -- some of them do, certainly not all --
25 freely advertise chequing facilities, and they are
26 competing for demand deposits. Also my view is
27 based on my conception of the character of competition
28 in a capital market, and in the Canadian capital
29 market in particular.

30 I think that competition, particularly after



1 the turn of the century, has always been of two kinds;
2 competition between particular companies within a
3 given type of institution and competition between
4 types of institutions. We have seen very substantial
5 competition between instalment finance companies and
6 banks as well as between different instalment finance
7 companies. We have seen substantial competition over
8 the years between loan companies and trust companies,
9 and on the assets side of the balance sheet, substantial
10 competition between life companies and mortgage companies
11 and trust companies. So that always an important
12 characteristic of our capital market has been competition
13 between types of institutions.

14 I think this is the kind of competition
15 that might be compromised through too close association
16 between different types of institutions. In this
17 case I think that if trust companies were quite
18 independent from banks we might find that they would
19 indeed over a time become more and more and more
20 competitive with banks which, generally speaking,
21 would be a desirable trend of development.

22 COMMISSIONER HARROLD: You do not see then
23 some difficulty between the links or ties between
24 finance intermediaries and non-finance intermediaries,
25 big business organizations having the same objectives?

26 PROFESSOR NEUFELD: No, I do not think
27 that the difficulty -- if one confines ones attention
28 to the operation of the capital market, I do not
29 think the difficulties are nearly as great there
30 as they are in the case of the association between two



1 types of finance intermediaries.

2 COMMISSIONER HARROLD: You have an interesting
3 percentage figure for the size of the finance
4 intermediaries at page 37.

5 PROFESSOR NEUFELD: Yes.

6 COMMISSIONER HARROLD: You use the 20 per
7 cent figure. How did you arrive at that as being the
8 reasonable size for any one finance institution?
9 Is not the trend for more and more and more amalgamations
10 and so on?

11 PROFESSOR NEUFELD: Well, I think that
12 the trend in the case of most financial intermediaries
13 except life insurance companies, has been towards
14 fewer and fewer companies. It was the case with
15 chartered banks and it was the case with building
16 societies, as they became mortgage loan companies.
17 It is the case with trust companies, and it is now
18 even recently becoming the case with instalment finance
19 companies.

20 I would say this is an entirely desirable development.

21 I do think that the optimum size of a
22 company might well be one which constitutes 20 per
23 cent of the market. If you ask me how did I get that
24 figure, I must admit that it is not a very sophisticated
25 one. It is a rough estimate and it gives the order of
26 magnitude, because I think it might surprise a lot of
27 people that a company might have to have 20 per cent
28 of the market to be efficient, and I suspect it is
29 the case. But, I would not want the Commission to
30 take the 20 per cent figure as, in itself, very significant.



1 I do think we must face the possibility that a particular
2 financial institution must become very large, so all
3 the more reason to encourage competition between types
4 of institutions as well as between particular companies
5 within a given type of institution.

6 COMMISSIONER HARROLD: Well, then what
7 would you say the test is as to whether it is desirable
8 or undesirable? You suggest that it is desirable
9 that there be mergers of smaller companies?

10 PROFESSOR NEUFELD: Yes.

11 COMMISSIONER HARROLD: But in fact it quite
12 often happens that a large company takes over a small
13 one?

14 PROFESSOR NEUFELD: Or a large one another
15 large one.

16 COMMISSIONER HARROLD: Yes, and what would
17 you say the test is as to desirable or undesirable?

18 PROFESSOR NEUFELD: I would not apply any
19 rigid test. I would hope that no Minister of Finance
20 is required to say that if the institution becomes
21 larger than 20 per cent of the market amalgamations
22 must be forbidden. I would just hope that generally
23 the idea is sound, that concentration beyond some
24 point is not desirable. This might well operate as
25 between banks and finance companies and finance companies
26 and life companies in that the government of the day would
27 exercise its good judgment in assuring that amalgamation
28 does not go too far. I do not think I would put a
29 minister in the position of having to make a decision
30 based on a formula.



1 COMMISSIONER MACKINTOSH: You are not
2 suggesting that because we have eight banks we ought
3 to have more amalgamations to level them off at 20 per
4 cent each?

5 PROFESSOR NEUFELD: No, I certainly do
6 not suggest that we should. I do not suggest that
7 since we only have eight banks we should not have
8 further amalgamations, but I think it might matter
9 as to whether an amalgamation might be between the
10 two biggest, or if it were between the two smallest,
11 or one of the smaller ones and one of the biggest.

12 COMMISSIONER HARROLD: You would not be
13 in favour of an amalgamation between the two biggest
14 at the moment?

15 PROFESSOR NEUFELD: Essentially I would
16 not favour such an amalgamation.

17 THE CHAIRMAN: Well, with reference to
18 your remarks on the short term money market at page 38,
19 you suggest that there are quite a large number of
20 bond dealers in the market, but you would not
21 artificially restrict the number, but you do suggest
22 that it may be that if all the money market dealers
23 were required to meet higher minimum standards in
24 their role of "jobbers" of money market instruments
25 that the matter would take care of itself. Would
26 you elaborate a little bit on that? I am not quite
27 clear what you mean by that, or what really consti-
28 tutes an adequate fulfilment of the jobbing function.

29 PROFESSOR NEUFELD: Yes. I think an
30 adequate fulfilment of the jobbing function would be



1 the undertaking on the part of the dealers to always
2 make a market in money market instruments. I do
3 not think that all money market dealers now at all
4 times are in such a position.

5 Also I think that access to the Bank of
6 Canada is a valuable privilege for which the Bank
7 of Canada quite rightly can demand some quid pro quo,
8 and I think in this case the quid pro quo is one of
9 making a market at all times, and this would include
10 being prepared to take a position at all times in
11 money market instruments that are actively traded.

12 Now, if I may be permitted just to go
13 one step beyond this suggestion, I would say that
14 this should not necessarily mean that other dealers
15 should not have the privilege of going to the Bank
16 of Canada. I would say that the dealers that go
17 to the Bank of Canada for the purpose of financing
18 their short term position -- their money market
19 securities -- should be confined to those fulfilling
20 jobbing functions, but that other dealers, and any
21 dealer, perhaps, should have the privilege of going
22 there but not at the same rate as money market dealers,
23 but at rates that would be substantially higher than
24 those that apply to money market dealers.

25 I think there is something to be said for
26 having the Bank of Canada act as a lender of last
27 resort on some terms to a broad range of dealers.
28 I think that if we wish to have a pliable, flexible
29 and active short term money market we have
30 to confine it to relatively few dealers, and I think



1 the only sensible way of confining it is to require
2 them to meet certain standards.

3 COMMISSIONER BROWN: Would you distinguish
4 between being prepared to make a two-way market with
5 money market securities at all times and being prepared
6 to carry an inventory at all times?

7 PROFESSOR NEUFELD: I think that essentially
8 it is a question of being prepared to make a market
9 and to show by evidence of trading that a market has
10 been made at all times. I think the matter of
11 inventory is not quite as important. I think it is
12 true that if inventories are inadequate it is obvious
13 that the dealers cannot make a market if there are
14 buyers.

15 COMMISSIONER BROWN: Yes, but there have
16 been times when dealers have been asked to carry
17 inventories when they thought the market was going in
18 a positive direction, and while they were prepared to
19 quote themselves short they were not prepared to
20 carry a positive inventory. I am just asking you
21 if you are prepared to make a distinction between
22 those two qualifications.

23 PROFESSOR NEUFELD: Well, I do not think
24 I would make a very sharp distinction, because I do
25 think there is a tendency now for dealers under
26 conditions of stress to forget their jobbing function,
27 so that on occasion the market tends to disappear.
28 So that I think that while I would not wish to apply
29 rigid inventory requirements on them, I think as a
30 matter of course if they are making a market they have



1 to be prepared to buy even in a falling market at
2 some price.

3 THE CHAIRMAN: You also mention scrutiny
4 of the paper which comes into the market.

5 PROFESSOR NEUFELD: Yes.

6 THE CHAIRMAN: And you suggest that perhaps
7 the scrutiny is not adequate. Is there any evidence
8 that there is a significant problem in respect of
9 the quality of commercial paper in Canada?

10 PROFESSOR NEUFELD: I think that this
11 evidence does not normally appear, as long as things
12 are going along reasonably smoothly. I think that
13 there in fact have been one or two cases where paper
14 in the market has almost caused some difficulty. I
15 cannot really say that it has proved to be a very
16 big problem. I think though a development
17 of the last three or four or five years -- one
18 development of the last three, or four, or five years
19 in the capital market, has been the growth of short
20 term paper. This is not merely money market paper,
21 but short term borrowing on the part of many
22 institutional borrowers.

23
24 When such short term borrowing occurs outside
25 the banking system it sometimes occurs without adequate
26 scrutiny. While I cannot say for a certainty that
27 unless these credits are more closely scrutinized in
28 future than they have in the past there will be
29 difficulty, I have been worried several times when I
30 have inquired as to the routine which is followed in



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Toronto, Ontario

- 6762 -

1 checking the credit rating of paper which is subsequently
2 distributed, as to exactly the value of the scrutiny
3 that is carried out. I think that the matter would
4 be solved at least to a degree, if any money market
5 dealer who has the facilities of the Bank of Canada
6 is required to show that he in effect has adequate
7 machinery for investigating the credit rating of the
8 short term borrower whom he is accommodating.
9 I do not think it is adequate at present in all cases.



1 THE CHAIRMAN: Well, any dealers that are
2 acting in the role of jobbers, wouldn't you expect
3 that naturally they would scrutinize the paper?

4 PROFESSOR NEUFELD: Well, much of the
5 paper goes through the short term market on an other
6 than jobber basis.

7 THE CHAIRMAN: Yes, but you are suggesting
8 on the one hand, I assume, that the jobbers' function
9 be extended so that it more fully covers the market.

10 PROFESSOR NEUFELD: Yes.

11 THE CHAIRMAN: If that were so, it would
12 be a pretty good guarantee that there had been reasonable
13 scrutiny of the paper?

14 PROFESSOR NEUFELD: I think that is true.

15 THE CHAIRMAN: Jobbers taking the position
16 themselves would naturally be interested in that.

17 PROFESSOR NEUFELD: Yes.

18 COMMISSIONER BROWN: I am wondering if this
19 is putting a penalty on the jobbers who are using the
20 money market facilities; in other words, putting a
21 penalty on money market brokers in that this commercial
22 paper is also dealt in by people who are not members
23 of the money market? I grant a greater volume

24 dealing with the

25 there are other
26 dealers who are not in that group or who have connections
27 with commercial enterprises that borrow on the short
28 term market, and you are putting a penalty on the
29 one group and leaving the others able to operate
30 without having to put their method of operation under



1 the eyes of the Bank of Canada?

2 PROFESSOR NEUFELD: I think this penalty
3 would be offset by the fact these institutions would
4 have access to the Bank of Canada through purchase
5 resale agreements on a more favourable basis than
6 the other dealers.

7 COMMISSIONER BROWN: Yes, but they have that
8 only on the money market instruments.

9 PROFESSOR NEUFELD: Yes, on the money market
10 instruments.

11 COMMISSIONER BROWN: And they would not have
12 it on this commercial paper -- unless you propose this
13 be extended so that they in time do develop into formal
14 acceptance houses.

15 PROFESSOR NEUFELD: I think in time there
16 would not be any difficulty in extending it to
17 commercial paper. Although I think
18 at the present time the dilemma you state is a real
19 one, I think it would be in time offset by the fact that
20 money market dealers would have/cheaper access to the money market
21 through the Bank of Canada. I think 14/would account
22 for a very large portion of the total short term paper
23 placed, and I think the rest would soon be regarded as
24 sort of fringe activities, and if these 14 dealers, in
25 fact, were required to establish credit appraisal
26 machinery of a formal kind, I think it would not
27 be long before it would be recognized that this
28 is the responsible way to do it and that dealers who
29 were not doing it probably should not be dealt with.
30 I think it is impossible to lay down formal requirements.



1 I would think it can be done only in terms of the
2 requirements for having access to the Bank of Canada.

3 THE CHAIRMAN: What is your view of the
4 provincial issues in parity bonds?

5 PROFESSOR NEUFELD: I am a bit frightened
6 over the substantial growth in parity bonds and other
7 forms of demand instruments because there have been
8 periods in the past when such short term financing
9 has suddenly caused difficulty. It may be that the
10 future will be kinder to the country than the past
11 has been; I don't know. I certainly would not on
12 principle be against the use of some demand money,
13 but I think that the people who are issuing demand
14 money should be perfectly aware of the fact there
15 have been occasions in the past when excessive short
16 term borrowing has caused difficulty for them.

17 THE CHAIRMAN: Towards the end of your
18 brief you suggest that insurance companies might be
19 persuaded to purchase more in the way of equity stocks
20 and, in fact, to assume underwriting responsibilities
21 under certain circumstances. Insurance companies
22 have been before us and this problem was discussed to
23 some extent. They are perhaps mildly interested, but
24 I think they consider their main function is to
25 make sure that the policy holders will be fully paid,
26 that that is their main function, and any dealings
27 in equities are regarded as a minor activity. You
28 suggest that perhaps they might be induced to change
29 their attitude: why would you suggest that they get
30 into that form of security?



1 PROFESSOR NEUFELD: Well, I suggest it in
2 part because I disagree with their interpretation of
3 their function. I think their function, in the case
4 of stock companies is to maximize profits, and in the
5 case of mutual companies to maximize dividends to
6 participating policy holders and to minimize the
7 cost of premiums. I think if this is the criterion
8 they choose they should have been in stocks to a
9 greater extent than they have been. Their profit
10 experience would have been better had they been in
11 stocks than it has been because they have decided,
12 rather, to choose as their criterion their meeting
13 of obligations in the unit of account. I think, also,
14 it has not always been this way in Canadian life
15 companies -- at least, particular companies did
16 not always operate this way. The participation of
17 Canadian life companies in equities has a rather
18 exciting history. This practice was rudely shaken
19 in the thirties.

20 THE CHAIRMAN: Perhaps if they had kept
21 the equities they had at that time they would have
22 gained by it in the long run.

23 PROFESSOR NEUFELD: I think there is no
24 doubt, if one went through that exercise, that the
25 particular companies that unloaded their equities
26 would today be far better off if they had kept them.

27 Several things have happened that worry me:
28 first, the life company investment officers are unduly
29 influenced by this really earth-shaking depression
30 of the thirties; and secondly, having lived under the



1 guiding hand of the life insurance supervisors for such
2 a long time, they have now become more conservative
3 than the government supervisors, and it may well be
4 that it has been this restrictive hand -- not merely
5 in terms of ratios, because they haven't come up to
6 ratios -- but merely the sentiment expressed on
7 every occasion, relating to risk investments by life
8 companies. The sentiment expressed by the official
9 authority has finally convinced the life insurance
10 investment officers that he indeed is right, and I
11 would say probably he is not right, and that they
12 should not accept the sentiments of the official
13 controllers as seriously as they have done.

14 COMMISSIONER BROWN: Their argument was
15 based in large part on the fact their reserves are
16 somewhere in the region of 6 per cent of total assets,
17 and if they went up to 15 per cent in equities, and
18 there was a 30 per cent drop in the market, and if
19 this came about at the end of the year when devaluation
20 had to take place, 30 per cent of the 15 per cent
21 would make quite a hole in their reserves. Perhaps
22 you have something to offer about a better or more
23 acceptable way of valuation so this would not be a very
24 large factor.

25 PROFESSOR NEUFELD: I am not sure whether
26 the life companies are not overdoing that argument,
27 because they did for a period operate with higher
28 equity ratios than they have now.
29
30



1 If they are not overdoing the argument I would
2 certainly be in favour of a change in the way reserves
3 have to be computed rather than compromise on the
4 issue of their participation in equities. I agree
5 that their reserve evaluations must be somewhat
6 different from those of the life companies in the
7 United Kingdom, but I would also say that if that
8 is so it would be better to remove the obstacles
9 than to permit them to continue with this almost
10 insignificant participation in equity financing.

11 THE CHAIRMAN: You put this proposition on
12 the ground that it is their duty to their shareholders
13 or policyholders, as the case may be, to produce
14 the greatest possible profit to be distributed to
15 the parties who are entitled to it, and they are
16 not doing it.

17 PROFESSOR NEUFELD: That is right.

18 THE CHAIRMAN: You do not put it on the
19 ground that in the general interest of the economy
20 as a whole that more equity money is required in
21 many respects; this is one possible source of equity
22 money that has not been fully exploited.

23 PROFESSOR NEUFELD: I think there are people
24 who are somewhat worried about the loss to foreign
25 owners of companies in Canada to Canadian companies.
26 While I, personally, am not nearly as upset about
27 this as many people are, I can only suggest that if
28 indeed this is the case, and if this is undesirable,
29 it may well be because the largest of our institutional
30 investors are ignoring, not entirely, but to a



1 substantial degree, that kind of investment. It
2 would, in other words, satisfy my feeling that life
3 companies should maximize return to policyholders
4 and shareholders, and it would also probably to
5 some degree satisfy those people who would prefer
6 to see a higher ratio of equity ownership remain
7 in Canada.

8 COMMISSIONER MACKINTOSH: There are, however,
9 two considerations, and I don't think one should
10 say that it was necessarily bad judgment in the
11 last four or five years for life insurance companies,
12 having regard to higher mortgage rates, bond yields,
13 to put most of their new money into those fixed
14 yield securities. It was a matter of judgment.
15 I don't think you could necessarily say their judgment
16 was unreasonable. Prior to that they did put some
17 significant amount into equities. I think you will
18 find the same thing if you examine their small equity
19 portfolios: you will find a large proportion of
20 American stocks, on the grounds that the small
21 supply of Canadian equities has been bid up to
22 a height where it was more profitable to buy American
23 equities.

24 PROFESSOR NEUFELD: I am not overly
25 concerned with the matter of foreign ownerships,
26 so I would not worry about that. However, on your
27 first point, as to the rate of return, in the
28 brief of the Life Officers Association they show
29 rates of return on various kinds of investments
30 over a 10-year period, and they also show what they



1 call the investment expenses relating to each type.
2 In nine out of ten of those years the highest net
3 rate of return was on stocks, and only in one
4 year was the rate of return on stocks as low as
5 it was on mortgages. So, I suspect that on a yield
6 basis the life insurance companies have foregone
7 their most profitable form of investment.

8 COMMISSIONER MACKINTOSH: What were the
9 ten years?

10 PROFESSOR NEUFELD: 1951 to 1960, I think
11 it was.

12 COMMISSIONER MacKEEN: Does your opinion
13 also apply to pension funds?

14 PROFESSOR NEUFELD: My general
15 impression is -- and I cannot speak with as much
16 feeling as I do in the case of life companies, because
17 pension funds are much more difficult to come to
18 grips with -- my general impression is that the
19 laws governing pension funds have been written
20 by the same people who wrote the Insurance Act.

21 COMMISSIONER MacKEEN: The need
22 there may be even greater because of the increase
23 in salaries and wages as the years go on, and the
24 ultimate pension may be greater, whereas with the
25 life companies it is a fixed return on an actuarial
26 basis.

27 PROFESSOR NEUFELD: I think the
28 pension funds warrant exceedingly close attention
29 because they are the kind of fund that will grow
30 and grow and grow. They are different in that sense



1 from particular financial institutions which typically
2 grow very quickly and then level off. I think this
3 may not be the case with pension funds and I, therefore,
4 quite agree ~~their~~ importance in future is likely
5 to be very great.

6 COMMISSIONER MacKEEN: What I had in
7 mind was that a fairly common basis for a pension
8 is, we will say, the average earnings of the last
9 five years of employment, and that amount becomes
10 greater when the pensioner reaches pensionable
11 age, and it destroys the value of any actuarial
12 basis; so that a growth in the investments in such
13 a fund is important.

14 PROFESSOR NEUFELD: I agree.

15 THE CHAIRMAN: Thank you very much,
16 Professor Neufeld. We appreciate your presence here,
17 and the discussion has been most helpful to us.

18 PROFESSOR NEUFELD: Thank you.

19 THE CHAIRMAN: We will adjourn now until
20 tomorrow morning at 9.15 when we will hear a submission
21 from the Superintendent of Insurance.

22 --- Adjournment.
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24
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2.

Royal Commission on Banking and Finance

CONSUMERS' ASSOCIATION OF CANADA

PROFESSOR E. P. NEUFELD

Hearings
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SUBMISSION

OF THE

CONSUMERS' ASSOCIATION OF CANADA

TO THE

ROYAL COMMISSION ON BANKING AND FINANCE

CONSUMERS' ASSOCIATION OF CANADA
1245 Wellington Street
Ottawa 3 Canada

August 1962



1
2 Gentlemen:

3 This submission is limited to a consideration
4 of consumer credit contracts and the need for
5 legislation requiring that those who extend consumer
6 credit disclose in the contracts all necessary
7 information respecting finance charges.

8 The Consumers' Association of Canada is a
9 national non-profit, non-political organization with
10 membership open to any resident in Canada. A major
11 aim of this organization is to provide consumers
12 with protection over the widest possible area of
13 consumer goods and services. Our economy is gradually
14 moving from a cash economy to a credit economy.
15 Consumers are increasingly complicating their pur-
16 chasing decisions by buying on credit terms without
17 all the factual information necessary to use credit
18 wisely. For this reason, and for the third time,
19 we supported the intent of a disclosure bill as
20 presented by Senator David Croll. In January 1962,
21 Senator Croll presented his third bill, Bill S-2 (an
22 act to make provision for the disclosure of information
23 in respect of finance charges).

24 Consumers have the right to know exactly
25 the total amount of finance charges in dollars and
26 cents and in terms of simple annual interest when
27 entering into a credit contract. Without this infor-
28 mation, consumers have no standard by which to make a
29 rational business decision. Hon. Paul H. Douglas,
30 in his speech on the "Truth in Lending Bill" S1740
before the American Congress, April 27th, 1961,
quoted the following from Dr. Theodore O. Yntema, Vice-
President in charge of finance of the Ford Motor
Company, while testifying during the Senate hearings



1 on automobile financing:

2 "The variety and complexity of finance and
3 insurance arrangements and the charges for
4 them are such as to almost defy comprehension.
5 It is impossible for the average buyer to
6 appraise the rates for the finance and
7 insurance services offered, as compared with
8 alternatives available elsewhere."

8 During the debate on Senator Croll's disclosure bill,
9 it was argued by Senator Hayden (Senate Hansard, page
10 265, 1962) that many people were not interested in the
11 cost of the loan:

12 "That while they have money they will
13 spend it to the extent that it will give
14 them everything they want to enjoy."

14 We grant that this statement holds true for some
15 consumers. Nevertheless, our position is clear --
16 consumers have the right to full information. Whether
17 or not they all use it is irrelevant. Even if only a
18 minority of consumers use the information, the effect
19 will be important and culminative.

19 Consumer spending totals over twenty-two billion
20 dollars per year. An official of Industrial
21 Acceptance Corporation stated at our recent Consumers'
22 Conference that presently in Canada there is a grand
23 outstanding total of consumer credit of 4.6 billion
24 dollars. Trade and Industry recognize that the consumer
25 is at the very source of his prosperity or failure.
26 Much of our purchasing is "blind buying". To be
27 intelligent consumers we require full information in
28 credit contracts and the assistance of standards and
29 accurate labelling. The importance of informed
30 consumers is underlined by President Kennedy's
widely quoted statements in his message to Congress
concerning his Consumers' Protection and Interests

on automobile financing:

"The variety and complexity of finance and insurance arrangements and the charges for them are such as to almost defy comprehension. It is impossible for the average buyer to appreciate the rates for the finance and insurance services offered, as compared with alternatives available elsewhere."

During the debate on Senator Griffin's disclosure bill, it was argued by Senator Hayden (Senate Finance, 1962, 1963) that many people were not interested in the cost of the loan:

"That while they have money they will spend it to the extent that it will give them everything they want to enjoy." We grant that this statement holds true for some consumers. Nevertheless, our position is clear -- consumers have the right to full information. That or not they use it is irrelevant. Ever if only a minority of consumers use the information, the effect will be important and cumulative.

Consumer spending totals over twenty-two billion dollars per year. An official of Industrial Acceptance Corporation stated at our recent Consumer Conference that presently in Canada there is a gross outstanding total of consumer credit of \$4.6 billion dollars. Trade and industry recognized that the amount is at the very source of his propensity to finance. Much of our purchasing is "blind buying". To be intelligent consumers we require full information in credit contracts and the assurance of standards and accurate rate limits. The Government's interest in and action by President Kennedy's widely quoted statements in his message to Congress



1 Programme. He stated:

2 "We nevertheless cannot afford waste in
3 consumption any more than we can afford
4 inefficiency in business or government."

5 Later he said:

6 "If the consumer is unable to choose on an
7 informed basis, then his dollar is wasted,
8 his health and safety may be threatened
9 and the national interest suffers. On the
10 other hand, increased efforts to make the
11 best possible use of their incomes can
12 contribute more to the well-being of most
13 families than equivalent efforts to raise
14 their incomes."

15 Those engaged in the business of
16 extending credit have stated that disclosing the
17 total cost of a loan in dollars and cents is suf-
18 ficient information for a borrower without giving
19 a valid percentage calculation. We submit a hypo-
20 thetical case depicting an average situation. A
21 housewife is shopping for a chesterfield. Her choice
22 is narrowed to two chesterfields in stores A and B.

<u>Store A</u>		<u>Store B</u>	
Cash Price	\$350.00	Cash Price	\$315.00
Down Payment	30.00	Down Payment	30.00
Unpaid Balance	<u>\$320.00</u>	Unpaid Balance	<u>\$285.00</u>
Monthly payment for 2 years	\$ 15.60	Monthly payment for 2 years	\$ 14.25
Total money paid	\$374.40	Total money paid	\$342.00
Cost of Loan	\$ 54.40	Cost of Loan	\$ 57.00
Rate of Charge	16.3%	Rate of Charge	19.2%

23 The formula used to compute this rate of charge is
24 widely used by many organizations. It was one selected
25 by the Federal Reserve Board of the United States
26 of America and is the formula Consumers' Association
27 of Canada used in the small brochure "Credit Costs
28
29
30



1 Money" which was distributed to our members.

2 i) equals rate of charge

3 m) equals number of payments in one year

4 n) equals number of payments to discharge
5 debt

6 D) equals charge in dollars

7 P) equals principal or cash advance

8 i) equals $\frac{2mD}{P(n+1)}$

9 Whenever the amounts or maturities vary
10 in considering a loan, a percentage rate is necessary
11 for intelligent comparison. Since the cash prices
12 varied in the above example, the need for the percentage
13 rate is demonstrated. With the above factual information
14 the consumer is equipped to shop for credit and to
15 make a choice suitable to her circumstances.

16 According to a Montreal press release covering
17 a recent "Canadian Consumer Credit Conference", it was
18 predicted that by 1970, 70% of department store and
19 variety store sales will be done on a credit basis.
20 The use of credit in purchasing consumer goods is no
21 longer limited to low income groups. A. W. Troelstrup
22 presented a paper at the Eighth Annual Conference on
23 Consumer Information in April 1962. He told of a
24 survey conducted by A. C. Sectorsky, the sociologist,
25 among families in a prosperous New York suburb, all
26 the families were supported by salaries between
27 \$12,000 and \$30,000 per year. He found that the
28 average family covered in this survey spent 40% more
29 than their income. Sectorsky and Troelstrup go into
30 the probable causes of this situation, which though
interesting, are not pertinent to this submission.
Whatever the reason, consumer credit appears to be
the most effective of all sales promotion schemes.



1 Opponents of disclosure of cost of financing
2 including "the rate of charge" raised two main
3 objections to meeting this requirement. The first is
4 the difficulties of computing financial charges in
5 terms of a percentage calculation. We are aware
6 of the complexities of this problem. Our organization
7 strongly endorses the solution offered by Bill S-2
8 which would provide that the Government of Canada will
9 control the manner of calculations and degree of
10 accuracy necessary in computing finance charges
11 and calculating the simple annual interest rate to be
12 shown in contracts. The difficulties were ably shown
13 by Mr. E. F. K. Nelson of the Canadian Retail
14 Federation in his submission to the Senate Banking
15 and Finance Committee on July 14, 1960. Senator
16 Bouffard, in Senate Hansard, February 22nd, 1961,
17 in Appendix C, submitted a bewildering array of
18 formulae. Statisticians and economists have debated
19 this matter for years. Professor E. P. Neufelt of the
20 Political Science Department of the University of
21 Toronto said at our recent Consumers' Conference.

22 "Reducing consumer ignorance over the
23 nature of consumer credit contracts is
24 not merely desirable but highly necessary."
25 He stated that there are difficulties in computing
26 such rates but the per annum rate need be correct
27 only to about 1/2% or 1% to serve the purpose of
28 enlightening the consumer and that avoiding unneces-
29 sarily complicated instalment arrangements would
30 reduce computing difficulties. We note in Senate
Hansard of this year on page 437 a copy of a letter
from R. G. Staunton, Chairman of the Department
of Mathematics, University of Waterloo. The letter is
written to the Toronto Daily Star and states that



1 mathematically it is quite possible to calculate
2 effective interest rates and tabulate them for the
3 layman's use.

4 The second reason¹ posed for not revealing
5 cost of loans giving a valid percentage rate is that
6 reputable credit granting organizations would be
7 forced to quote very high rates for small short term
8 loans. We believe that this is a matter for consumer
9 education. Informed managers of the family income
10 should know that the cost of consumer credit includes
11 the cost of opening the account, investigation,
12 collection and bad debts. These costs differ little
13 from big loans to small short term loans and therefore
14 such small loans carry a comparatively high percentage
15 charge. Armed with this information, the consumer
16 can judge the value of the service against the cost when
17 buying and borrowing.

18 Senator Croll, while supporting Bill S-2
19 in April 1962, reported that this problem of the need
20 for informed consumers regarding the cost of credit
21 was dealt with in the Royal Commission on Canada's
22 Economic Prospects.

23 In the Volume "Financing of Economic Activity in
24 Canada" on page 196, we find:

25 "We are however concerned with one aspect
26 of this matter. This is the burden imposed
27 on the economy by the consumer's
28 ignorance of the costs of the money he
29 borrows."

30 Then again on page 439:

"The insensitivity of consumer borrowers
to the costs of funds may be impossible
to overcome but as we suggested in Chapter 5
we should at least take steps to ensure



... is quite possible to calculate

effective interest rates and calculate them for the

lender's use.

The second reason for not revealing

cost of loans giving a wide percentage rate is that

reputable credit granting organizations would be

forced to quote very high rates for small short term

loans. We believe that this is a matter for constant

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of informed consumers regarding the cost of credit

was dealt with in the Royal Commission on Canada's

in the Volume "Financing of Economic Activity" in

"Canada" on page 106, we find:

"We are however concerned with one aspect

of this matter. This is the problem of the

on the economy by the consumer's

ignorance of the costs of the money he

borrows."

Then again on page 107:

"The insensitivity of consumers to the

to the costs of loans and the consequent

to overcome but as we suggested in "Canada"

we should at least take steps to ensure



" that individuals are informed of the
rate of interest they are required to pay."

Later in the volume:

"It may be necessary to exercise Parliament's
jurisdiction over matters pertaining to
rates of interest and pass legislation
requiring uniform clear announcement of
the rate of interest charged on loans to
consumers in terms of some common formula."

In closing, our organization is
confident that three objectives which are valuable
to Canadian welfare would issue from legislation
making full disclosure of finance charges obligatory
in all credit contracts.

1. Consumers would use their purchasing power
more efficiently. They would have greater
confidence in the integrity of those
engaged in credit financing. Citizens are
coming to view with some suspicion the
withholding of any facts pertinent to their
business as purchasers of consumer goods.
- 2, Competition in the credit finance business would
be stimulated. The Consumers' Association
of Canada believes that our high standard
of living is protected by competition in our
economy. Senator Douglas in his speech
to Congress April 27th, 1961, quotes from
one of the witnesses supporting his bill:

"Annual rate disclosure is part and
parcel of purest classical economics
and the basic principle of the free
enterprise systems -- the rational informed
many, buying in the free market place
with full knowledge of prices and



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Toronto, Ontario

- A.8 -

1 " making a decision which is best for him
2 and therefore best for the whole economy."

3 3. Such competition would spur credit finance
4 businesses to greater efficiency and so
5 reduce the cost of this service.

6 Respectfully submitted

7 on behalf of the

8 Consumers' Association of Canada

9 (signed) Jean S. Wilson

10 Mrs. V. W. G. Wilson
11 Chairman,

12 Committee on Consumer Credit
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August 1962



Nethercut & Young
Toronto, Ontario

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SUBMISSION

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TO THE

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ROYAL COMMISSION ON BANKING AND FINANCE

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E.P. NEUFELD

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From:- Edward P. Neufeld,
Department of Political Economy,
University of Toronto,
Toronto, Ontario.

Honourable Dana Porter, L.L.D.,
Chairman, Royal Commission on Banking and Finance,
P.O. Box 1502,
Postal Station "B",
Ottawa, Ontario.

Dear Sir:

I am pleased to enclose my Submission to the Royal Commission on Banking and Finance. I include in this letter a brief summary of my views, recommendations and suggestions, all of which are submitted in my personal capacity. The writer appreciates the honour of being given an opportunity to present his views in this way.

The Submission is composed of two main parts, the first dealing with the problem of economic instability, the second with the functioning of the capital market. Recommendations are lengthy and so are not fully included in this outline.

PART ONE

THE PROBLEM OF ECONOMIC INSTABILITY

I. The Tasks of Economic Stabilization Policy

(1) Objectives

Only through the development and use of effective control techniques and through co-ordination of the various techniques will we eventually be able to determine what economic objectives can be achieved. With this in mind



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3 the Government of Canada should establish an economic
4 stabilization board or committee, composed of repre-
5 sentatives of the various government departments and
6 Bank of Canada, with a permanent Chairman and re-
7 search staff and with specific tasks to perform.
8

9 In a general way it may be said that economic stabili-
10 zation policy should have as its objective the achieve-
11 ment of a low level of unemployment, a high rate of
12 economic growth, relative price stability, and an
13 equitable distribution of the costs which are inflicted
14 on individuals by any economic instability which it
15 has not been possible to remove -- all within the
16 framework of techniques which interfere as little
17 as possible with the efficient functioning of the
18 capital market.

19 (2) Nature of Canada's Economic Instability

20 and

21 (3) Specific Tasks of Stabilization Policy

22 The nature of Canada's economic instability is such
23 that those responsible for implementing stabilization
24 policy should regard themselves as being faced with
25 the following tasks:
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- (a) to control cyclical spending in the private sector in general;
- (b) to ensure that particular sectors do not become so volatile as to produce harmful economic distortions;
- (c) to increase the mobility of labour and capital, particularly between the public and private sectors of the economy;
- (d) to improve the flow of information to the private sector of the economy so as to reduce instability arising from business decisions based on incorrect or incomplete information;
- (e) to deal specifically with "cost-push" inflation;
- (f) to help ensure that the costs imposed on individuals by economic instability which it has not been possible to remove are borne equitably.

II. Techniques of Economic Stabilization

- (1) Monetary policy, fiscal policy, and debt management have been less than adequately successful in the past because of insufficient co-ordination between them,



1
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3 because of their being insufficiently flexible,
4 because their implementation has resulted in
5 unnecessary but significant disruptions to the
6 smooth functioning of the capital market,
7 because of uncertainty surrounding the direc-
8 tion which official policy has appeared to be
9 taking, and because of the rigidity of certain
10 institutional interest rates.

11
12 Recommended improvements in techniques in
13 addition to the already mentioned formation of
14 an economic stabilization committee or board
15 are: changes in the Bank of Canada Act which
16 would clearly indicate that the Minister of
17 Finance acting for the Governor-in-Council is
18 responsible for monetary policy at all times,
19 as well as being responsible for fiscal, debt
20 and exchange rate policies; improvement in
21 the quantity, quality and timeliness of econ-
22 omic indicators; use of fiscal policy and debt
23 management as a supplement to monetary
24 policy in controlling the supply of money; im-
25 provements in the lines of communication
26 between "Ottawa" and the capital market and
27 in the market expertness of those implementing
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3 stabilization policy; re-introduction of a
4 "fixed" Bank Rate; removal of the ceiling
5 on chartered bank lending rates; more de-
6 tailed reporting of central bank operations
7 and decisions.

8
9 It is our view that additional techniques
10 for controlling bank cash, such as a sys-
11 tem of special deposits are unnecessary;
12 that additional controls for economic
13 stabilization should not be imposed on non-
14 bank financial intermediaries; that any
15 further separation of decision-making re-
16 lating to monetary and debt management
17 should be avoided; and that the Bank of
18 Canada should continue to function as a
19 separate entity and not as part of a depart-
20 ment of government.

- 21 (2) Supplementary techniques should be available
22 to influence, if necessary, the particularly
23 volatile sectors of business capital spending
24 and spending on consumer durable goods;
25 variable depreciation allowances should be
26 used with flexibility; and means should be found
27 to vary down-payment and repayment provisions
28 of consumer credit contracts.
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4 (3) The Government of Canada should take the
5 initiative in encouraging provinces to adopt
6 anti-cyclical capital spending plans.
7

8 (4) Business should be supplied with improved
9 statistical information relating to the state
10 of industrial capacity and the behaviour of
11 inventories.
12

13 (5) The proposed economic stabilization board
14 should develop statistical data which would
15 serve as guide lines to wage settlements
16 and pricing policies in industries whether
17 adequate competition on one or both sides
18 of the bargaining table is absent.
19

20 PART TWO

21 FUNCTIONING OF THE CAPITAL MARKET

22 The basis of the functioning of the capital market should con-
23 tinue to be the inter-play of competitive forces. Obstacles to effective
24 competition should be removed. Solutions to market deficiencies should,
25 if possible, be of a kind which improve rather than supplant the opera-
26 tion of the market.
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4 (1) It is possible that competition over the long-run period
5 would be improved if banks were prohibited from hold-
6 ing more than a nominal amount of the equity of partic-
7 ular trust companies, and if directors of trust
8 companies were precluded from becoming directors of
9 chartered banks.

10 Amalgamations and mergers between smaller
11 financial institutions should be permitted but not
12 those which increase the share of the market of
13 the already very large institutions.

14
15 (2) Minimum standards of the "jobbing" performance of
16 money market dealers should be raised, and measures
17 should be taken to ensure that credits utilizing the
18 facilities of the short-term money market are scru-
19 tinized as closely as are customers of the chartered
20 banks.

21 (3) Retaining ownership of Canadian industry in Canada
22 might be enhanced if the investment policies of life
23 insurance companies were more venturesome, and
24 perhaps if the capital available for underwriting was
25 increased. Term lending by banks should not be dis-
26 couraged and debt and equity financing should be
27 placed on an equal basis as far as income taxes are
28 concerned.
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4 (4) Fiscal difficulties of municipalities should not be
5 remedied by changes in the capital market. A
6 system of credit rating for municipalities should
7 seriously be considered.
- 8 (5) Government credit institutions should be required
9 to make available information which would enable
10 an "outsider" to judge whether or not they are ful-
11 filling their originally assigned role.
- 12
13 (6) The Canadian Bankers' Association, the Investment
14 Dealers' Association and the Dominion Mortgage and
15 Investments Association should expand their activities
16 to include a continuing appraisal of alleged deficiencies
17 in the capital market and should encourage the adoption
18 of remedial measures.

19
20 Yours sincerely,

21 *E. P. Neufeld*

22 E. P. Neufeld.
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Practical difficulties of more legislation should not be
repeated by changes in the capital market. A
...
...
... be considered.

Government credit institutions should be required
to make available information which would enable
an "outsider" to judge whether or not they are ful-
filling their obligations assigned to them.

The Canadian Bankers' Association, the Investment
Dealers' Association, and the Dominion Mortgage and
...
...
to include a committee composed of alleged delinquents
in the capital market and should encourage the adoption
of remedial measures.

Very sincerely,

L. P. Wadsworth.



PART ONE

THE PROBLEM OF ECONOMIC INSTABILITY

The problem of instability in Canada's rate of economic growth and general level of prices is neither transitory nor short-run; its presence has been statistically documented for a period covering many decades and there is little doubt that it has adversely affected the country's long-run rate of economic performance. It cannot be disputed therefore that a determined effort to improve our ability to cope with the problem is fully justified. It is within this context that the role and operation of the Bank of Canada must be discussed.

I. The Tasks of Economic Stabilization Policy

Before it is possible to make useful suggestions for improving our control techniques it is necessary to form rather specific views on (1) the objectives to be sought and (2) the nature of the problem of economic instability, and (3) the specific tasks of stabilization policy.

(1) Objectives of Economic Stabilization

There is now general agreement that the objectives of stabilization policy should be to maintain relative full employment, to ensure adequate stability in the general level of prices, and to permit, indeed encourage, the economy to expand at a maximum sustainable rate of economic growth. There is no general agreement as to the numerical interpretation

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The Task of Economic Stabilization Policy

Before it is possible to make useful suggestions for improving our control techniques it is necessary to form rather specific views on (1) the objectives to be sought and (2) the nature of the problem of economic instability.

(1) Objectives of Economic Stabilization

There is now general agreement that the objectives of stabilization policy should be to maintain relative full employment, to ensure adequate stability in the general level of prices, and to permit, in due course, the economy to expand at a maximum sustainable rate of economic growth. There is no general agreement as to the manner of implementation.

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3 (1) Objectives of Economic Stabilization (cont'd)
4 of the words "relative", "adequate", and
5 "maximum sustainable" that should be accepted
6 by the policy maker. Disagreement in this
7 respect, however, reflects less a varying
8 social consciousness among those expressing
9 an opinion on the matter than it does the absence
10 of concrete evidence of the extent to which the
11 aforementioned objectives can be achieved with-
12 in the framework of a mixed free enterprise economy.
13 We simply do not know what can be achieved.

14 It seems foolish therefore to present the policy
15 maker with precise instructions as to the amount
16 of unemployment that is tolerable, the degree of
17 movement in the general level of prices that is
18 acceptable, and the rate of economic growth which
19 he should help to achieve. But there is every
20 reason to expect the policy maker to explain in
21 detail what he has done in attempting to achieve
22 economic stability and to indicate how successful
23 he has been, what problems he has encountered
24 in attempting to fulfill his role, and where in his
25 view further improvement lies. Only through
26 persistent appraisal of the problems facing the
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4 (1) Objectives of Economic Stabilization (cont'd)
5 policy maker, of the effectiveness of his control
6 techniques and the success of his policies, will
7 continuous improvement be made in meeting
8 price, employment and output objectives. Con-
9 tinuous improvement cannot come from a once-
10 for-all examination of the problems, techniques
11 and policies, however thorough and incisive that
12 examination may be. There is also great and
13 obvious need for close cooperation and consulting
14 on a continuing basis for reason of policy and
15 policy implementation among the various govern-
16 ment departments and the Bank of Canada - a
17 point to which we shall refer again.

18 RECOMMENDATION:

19 The Government of Canada should establish a permanent economic
20 stabilization board or committee composed of representatives from the
21 relevant government departments and the Bank of Canada, and assisted
22 by a permanent chairman and research staff, which should be respons-
23 ible for appraising the problems of unemployment, inflation, and
24 economic growth; for appraising the effectiveness of and planning the
25 coordination between current monetary, fiscal (i. e. economic policies
26 and programmes of all government departments), debt, and exchange
27 rate policies; for seeking improvements in stabilization techniques and
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3 policies; and for making recommendations to the government of the day.
4 A detailed report of the work and findings of the board should annually
5 be tabled in the House of Commons by the Minister of Finance.

6 One aspect of the objectives of economic policy is too often ignored,
7 primarily because statements of objectives frequently appear to assume
8 that full employment, price stability, and high economic growth can
9 permanently be achieved if only appropriate policies are pursued. We
10 have already suggested that only through persistent appraisal and im-
11 provement will we finally determine what can be accomplished in this
12 respect. But for the present we must accept the fact that periodically
13 not all people who wish to work will find work. If this is accepted,
14 then what should be the objective of the policy maker?

15 We would suggest that in a certain sense involuntary unemployment
16 is a cost of retaining the basic elements of the existing economic order.
17 Because this cost falls heavily on a small portion of the working popu-
18 lation, government policy should ensure that it is borne equitably.

19
20 Much, of course, is already being done to accomplish this objective,
21 and we mention it here for two reasons: first, to emphasize that the ob-
22 jectives of economic stabilization must become more complex if it is
23 assumed that desirable employment, price and growth objectives can-
24 not always be met; second, to suggest that if the social costs and there-
25 fore political pressures of unemployment are minimized, the policy
26 maker will enjoy increased freedom to pursue economically appro-
27 priate stabilization policy.
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30

policy; and for making recommendations to the government of the day. A detailed report of the work and findings of the board should annually be tabled in the House of Commons by the Minister of Finance.

One aspect of the objectives of economic policy is too often ignored primarily because statements of objectives frequently appear to assume that full employment, price stability, and high economic growth can permanently be achieved if only appropriate policies are pursued. We have already suggested that only through persistent and improved government will we finally determine what can be accomplished in this respect. But for the present we must accept the fact that periodically not all people who wish to work will find work. If this is accepted,

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We would suggest that in a certain sense involuntary unemployment is a cost of retaining the basic elements of the existing economic order. Because this cost falls heavily on a small portion of the working population, government policy should ensure that it is borne equitably.

Second, of course, is already being done to accomplish this objective and we mention it here for two reasons: first, to emphasize that the objectives of economic stabilization must become more complex if it is assumed that desirable employment, price and growth objectives cannot always be met; second, to suggest that if the social costs and losses to a political pressure of unemployment are minimized, the policy maker will enjoy increased freedom to pursue economic policy.

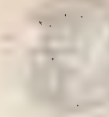
private stabilization policy.



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4 There is a final aspect to the matter of stabilization objectives which
5 we would wish the Commission to consider: it is the relationship between
6 those objectives and the techniques for achieving them. Certain control
7 techniques are in basic disharmony with the functioning of the capital
8 market (and other markets, for that matter), others are not. Stabiliza-
9 tion control techniques which negate the operation of the free capital
10 market lead logically to further controls designed to offset the ill-effects
11 of the former. Whether or not one regards such proliferation of controls
12 with equanimity will depend on one's over-all appraisal of and sympathy
13 for a market-oriented economy, and this will vary from person to person.
14 For the policy maker who is generally sympathetic with the view that a
15 relatively free capital market should be perpetuated, there is therefore
16 the additional policy objective of interfering as little as possible with that
17 type of market. The foregoing leads us to the following general recom-
18 mendation relating to the objectives of economic stabilization.

19 RECOMMENDATION:

20 Economic stabilization policy should have as its general objective
21 the achievement of a low level of unemployment, a high rate of economic
22 growth, relative price stability, and an equitable distribution of the costs
23 which are inflicted on individuals by economic instability which it has not
24 been possible to remove -- all within the framework of techniques which
25 interfere as little as possible with the efficient functioning of the capital
26 market.
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There is a final aspect to the matter of stabilization objectives which we would wish the Commission to consider: it is the relationship between the stabilization objectives and the development of the economy.

Stabilization control techniques which negate the operation of the free capital market are logically to further controls designed to offset the effects of inflation. With quantity will depend on one's overall appraisal of and sympathy for a market-oriented economy, and this will vary from person to person. For the policy maker who is generally sympathetic with the view that a relatively free capital market should be maintained, there is therefore the additional policy objective of interfering as little as possible with the operation of market. The foregoing leads us to the following general recommendations relating to the objectives of economic stabilization.

STABILIZATION

Economic stabilization policy should have as its general objective the achievement of a low level of unemployment, a high rate of economic growth, relative price stability, and an equitable distribution of income which are limited on individual by economic instability which it has no been possible to remove -- all within the framework of techniques which interfere as little as possible with the efficient functioning of the capital

(2) Nature of Canada's Economic Instability

It is intended here to confine our discussion to several aspects of the problem of economic instability which seem particularly relevant to our subsequent discussion of control techniques.

Some of our past business cycles have been mild, others have been severe. In most of them inventory accumulation, business capital spending, and consumer spending on durable goods have been volatile. The greater their volatility has been, the greater has been the volatility of output in general. A more sustained rate of economic growth we believe requires a more orderly expansion in those areas than has been the case in the past.

But it is difficult to prescribe for that instability before its nature is understood. We do not wish to review here the many theories of the business cycle which have been developed over the years, but do wish to suggest that businessmen may perhaps suddenly become unduly optimistic or pessimistic either because (a) their correct interpretation of current information and events leads them to believe rightly that sales and profits are likely to change substantially in future, or (b) their incorrect

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1
2
3 (2) Nature of Canada's Economic Instability (cont'd)
4 or incomplete interpretation of current information
5 and events leads them to forecast incorrectly their
6 sales and profit prospects. Because of the latter
7 possibility economic stabilization, curiously
8 enough, may include disseminating detailed and
9 current information on markets, plant capacity,
10 and inventory accumulation, as well as influencing
11 the cost and availability of credit, the size of con-
12 sumer spendable income, and the rate of spending
13 in the public sector.

14
15 A further aspect of the business cycle which merits
16 our attention is its varying intensity. If the cycle
17 happens to be mild then it is possible that the all-
18 pervasive effect of monetary policy and of that part
19 of fiscal policy which affects private and public
20 spending in a general way may be sufficient for
21 achieving a tolerable degree of economic stability.

22 But experience suggests that this may not be the
23 case when the cycle becomes severe. In such a
24 cycle many businessmen, for whatever reason,
25 appear to become rather insensitive to interest-
26 cost when planning their capital expenditure pro-
27 grammes; and consumers appear not to be
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Nature of Canada's Economic Instability (cont'd)
or incomplete information of current information
and events leads them to forecast inaccurately their
sales and profit prospects. Because of the latter
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and fiscal policy. It is not to be

(2) Nature of Canada's Economic Instability (cont'd)

influenced strongly by the cost of credit when contemplating purchases of durable goods. It is because of this aspect of the business cycle that control techniques aimed at particular volatile sectors may be necessary to supplement the aggregate techniques of monetary and fiscal policy.

Techniques which are designed to prevent particular sectors from becoming overly volatile are necessary not merely for controlling the business cycle but also for preventing sector distortions which in future cause trouble over a period longer than a business cycle. For example, the extreme investment "boom" of 1955 to 1957 resulted in two major distortions: over-investment in many industries, possibly leaving in its wake high unit overhead costs; and an excessive trade deficit. The latter was excessive not in the sense of frustrating our ability to control the business cycle, for the high level of imports proved to be a powerful anti-inflationary force, but rather in the sense that being accompanied by a rising premium on

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Techniques which are designed to prevent particular sectors from becoming overly volatile are necessary not merely for controlling the business cycle but also for preventing sectoral distortions which in future cause trouble over a period longer than a business cycle. For example, the extreme investment "boom" of 1955 to 1957 resulted in two major distortions: over-investment in many industries, possibly leaving in its wake high unit overhead costs, and an excessive trade deficit. The latter was excessive not in the sense of frustrating our ability to control the business cycle, for the high level of imports proved to be a powerful anti-inflationary force, but rather in the sense that being accompanied by a rising premium on



1
2 (2) Nature of Canada's Economic Instability (cont'd)
3 the Canadian dollar it involved a relative shift of
4 resources out of the export and import-competing
5 industries which was not sustainable once the ex-
6 cessive expansion was over. In other words, the
7 transitional economic costs of first shifting re-
8 sources massively in one direction and then
9 painfully (as our slow growth rate since 1957
10 attests) back again probably were heavy.

11
12 It is not likely that all sector distortions will
13 always be avoided. The mobility of labour and
14 of capital should therefore not be impeded and
15 perhaps should be enhanced. But since the major
16 distortion during "boom" periods is likely to be
17 excessive expansion in the private sector, a
18 solution to the problem in the subsequent period
19 of recession will involve a "catching up" of the
20 public sector. It is for this reason that greater
21 co-ordination between the federal government
22 and the provincial governments on capital spend-
23 ing plans has become necessary.

24 Both the intensity and the structure of the busi-
25 ness cycle are difficult, if not impossible, to
26 forecast. The policy maker is given little warning
27
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the Canadian dollar it involves a relative shift of resources out of the export and import-competing industries which was not sustainable once the excessive expansion was over. In other words, the transitional economic costs of just shifting resources massively in one direction and then painfully (as our slow growth rate since 1982 attested) back again probably were heavy.

It is not likely that all sector distortions will always be avoided. The mobility of labour and of capital should therefore not be impeded and perhaps should be enhanced. But since the major distortion during "boom" periods is likely to be excessive expansion in the private sector, a solution to the problem in the subsequent period of recession will involve a "catching up" of the public sector. It is for this reason that greater co-ordination between the federal government and the provincial governments on capital spending plans has become necessary.

Both the intensity and the structure of the business cycle are difficult, if not impossible, to forecast. The policy maker is given little warning

(2) Nature of Canada's Economic Instability (cont'd)
as to whether it will be mild or intense and as to
which sector or sectors will prove particularly
troublesome. This makes it essential that the
aggregate techniques of monetary policy and
fiscal policy, and the techniques designed to
supplement those policies in dealing with unusual
volatility in particular sectors, must be used
flexibly. In our view there are few obstacles in
the way of the flexible use of monetary and aggregate
fiscal policy, but there are in the use of
supplementary control techniques. These we
discuss below.

One remaining aspect of economic instability to
which we wish to refer is the matter of "cost-
push" inflation, that is inflation which arises
because of administrative increases in prices
of goods and wages made possible by monopoly
elements and made permanent by monetary ex-
pansion as soon as those price increases or
other factors begin to create unemployment.
Virtually all our stabilization techniques are
designed to counter "demand" inflation, that is
"excess spending" inflation; none to counter
"cost" inflation.



(2) Nature of Canada's Economic Instability (cont'd)

There is no general agreement as to the relative importance of "cost" inflation in a comprehensive explanation of increases in the general level of prices. The problem is too complex for existing tools of statistical measurement to be able to provide answers which would enjoy general agreement among informed observers. This difficulty is not likely soon to disappear. For that reason we believe that the only practical approach remaining is to assume that "cost" inflation has become sufficiently important to warrant an attempt to design techniques for dealing with it. If this is not done there is a danger that "demand" inflation techniques will be used to counter "cost" inflation with the end result of increased and excessive unemployment accompanying the attempt to stabilize the price level. The conflict between the objectives of low unemployment and price stability may require the development of control techniques designed to cope with "cost" inflation.

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cessive unemployment accompanying the attempt
to stabilize the price level. The conflict between
the objectives of low unemployment and price
stability may well be the development of control
techniques designed to deal with "cost" inflation.

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3 (3) Specific Tasks of Stabilization Policy

4 From the foregoing discussion of the objectives
5 which stabilization policy should seek to achieve
6 and of the character of economic instability, we
7 are able to summarize the specific tasks which
8 we believe stabilization policy faces:

- 9
- 10 (a) to control cyclical spending in the private
11 sector in general;
- 12 (b) to ensure that particular sectors do not
13 become so volatile as to produce harmful
14 economic distortions;
- 15 (c) to increase the mobility of productive
16 factors, particularly between the private
17 and the public sectors of the economy;
- 18
- 19 (d) to improve the flow of information to the
20 private sector so as to reduce instability
21 arising from business decisions based on
22 incorrect or incomplete information;
- 23 (e) to deal specifically with "cost-push"
24 inflation;
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State of the Union Policy

From the foregoing discussion of the objectives which stabilization policy should seek to achieve and of the character of economic instability, we are able to summarize the specific tasks which a balance stabilization policy faces:

(a) to control external spending in the private

sector in general;

(b) to ensure that particular sectors do not

become so volatile as to produce harmful

(c) to increase the mobility of productive

factors, particularly between the private

and the public sectors of the economy;

(d) to improve the flow of information to the

private sector so as to reduce instability

arising from overseas decisions based on

incomplete or inaccurate information;

(e) to deal specifically with "cost-push"

inflation.

(3) Specific Tasks of Stabilization Policy (cont'd)

- (f) to help ensure that the costs imposed on individuals by any economic instability which it has not been possible to remove are borne equitably.

We turn now to a discussion of the techniques which are required for executing the aforementioned tasks of economic stabilization.

II. Techniques of Economic Stabilization

We intend in this section of our Submission to discuss the deficiencies of our existing control techniques and the improvements we believe should be adopted. In order to show clearly the relationship between this discussion and that of the preceding section, we will discuss these deficiencies in relation to each of the specific stabilization tasks which have already been outlined.

(1) Techniques for controlling cyclical spending in general in the private sector

Monetary and fiscal policies are now, and no doubt will remain in future, the principal means available for influencing the general level of spending in the private sector of the economy. They can have an all-pervasive influence on the cost and availability of credit, on the rate of exchange, and on the amount of spendable income left in the hands of individuals and businesses. Expertness in the use

(2) Specific Tasks or Stabilization Policy (cont'd)

- (1) to help ensure that the costs imposed on individuals by any economic instability which it has not been possible to remove

We turn now to a discussion of the techniques which are required for executing the aforementioned tasks of economic stabilization.

II. Techniques of Economic Stabilization

We intend in this section of our discussion to discuss the deficiencies of our existing control techniques and the improvements we believe should be adopted. In order to show clearly the relationship between this discussion and that of the preceding section, we will discuss these deficiencies in relation to each of the specific stabilization tasks which have already been outlined.

(1) Techniques for controlling cyclical activity in general

in the private sector

Monetary and fiscal policies are now, and we doubt will remain in future, the principal means available for influencing the general level of spending in the private sector of the economy. There can have no all-pervasive influence on the cost and availability of credit, on the rate of exchange, and on the amount of government income left in the hands of individuals and businesses. Expertness in the use



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3 of those techniques is not yet what it might be,
4 but it is to be remembered that their conscious
5 and determined use has a very short history --
6 in our view not more than a decade -- and is
7 likely to improve with further experience. They
8 have the virtue that they interfere less with
9 markets than do more selective and more direct
10 types of control. Thought of replacing them with
11 other controls in a market-oriented economy can
12 be little more than idle speculation. They have
13 to be made to function reasonably well, the alter-
14 native being a major move away from our market-
15 oriented economy or an acceptance of cyclical
16 instability of past magnitudes.

17 (a) Lack of Co-ordination

18 In our view a major deficiency of past use of
19 aggregate monetary and fiscal policy, and also
20 debt management, has been a lack of co-ordination
21 between them. There have been times when the
22 management of the public debt has interfered
23 substantially with control of the supply of money.
24 There have been times in the last five years when
25 monetary policy has negated part of the desirable
26 effects of deficit spending, although this cannot
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2 be said for the period since June 1961. The
3 possibility of conflict in objectives makes co-
4 ordination essential.

5 But in addition, the nature of the technical re-
6 lationship between monetary, debt, and fiscal
7 policies is such that co-ordination is essential
8 on operational grounds as well. Fiscal policy
9 can influence the supply of money by varying
10 the amount of idle government cash balances;
11 efficient debt management involves purchases
12 and sales of securities by the central bank and
13 also involves close scrutiny of markets by the
14 central bank; and no Minister of Finance can
15 safely embark on an expansionary budget policy
16 unless he is assured of accommodating policy at
17 the central bank. Institutional arrangements
18 therefore should be such as to ensure that
19 co-ordination of policy objectives and of imple-
20 mentation of policy will be complete.

21
22 RECOMMENDATION:

23 The Minister of Finance acting for the Governor-in-Council should
24 unequivocally be responsible for all aspects of economic stabilization
25 policy -- monetary, fiscal, debt, and exchange rate. Since confusion
26 over this line of responsibility has existed only in relation to monetary
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2 policy, it is recommended that the Bank of Canada Act be amended to give
3 the Minister of Finance authority to issue directives to the Bank of Canada.
4 The Bank of Canada Act should also be amended to make the appointment
5 of Governor "at the pleasure of the Governor-in-Council", as well as for
6 a fixed period of time, but with the added provision that when a Governor
7 is removed or his appointment is not renewed he be given the opportunity
8 to appear before both the Senate and House of Commons Banking and
9 Commerce Committees before the expiration of his appointment.
10

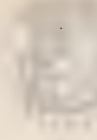
11 In an operational sense co-ordination of objectives and of the imple-
12 mentation of policy should be assured through the regular and frequent
13 meetings of the already mentioned economic stabilization board or com-
14 mittee.

15 (b) Lack of Flexibility

16 Both monetary and fiscal policy at present are insufficiently
17 flexible. This is a severe deficiency. Economic forecasting
18 is still so crude that it cannot give the policy maker much
19 warning of changes in the rate of economic expansion and
20 contraction, with the result that policy may have to be re-
21 versed on very short notice. Improvement in the timing
22 of policy changes can come through improvement in our
23 statistical data.

24 RECOMMENDATION:

25 The Government of Canada should devote sufficient resources to the
26 compilation of current statistical series, including business cycle indi-
27 cators, so that they are available to the policy makers and the general
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Commerce Committee before the expiration of his appointment.

In an operational sense co-ordination of objectives and of the implementation of policy should be secured through the regular and frequent meetings of the already mentioned economic stabilization board or committee.

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4 public as quickly as are the indicators in the United States. The quality
5 of some existing indicators should be improved.

6 Monetary policy has been too inflexible in the sense that the range
7 between monetary ease and monetary restriction within which it has
8 operated over the business cycle has been too narrow. The fact that
9 no one knows what constitutes the "right" supply of money at any given
10 moment may lead to an overly cautious policy. This problem would be
11 reduced if the central bank felt confident that mistakes could easily be
12 remedied. The fear that substantial monetary expansion during re-
13 cession will be difficult to offset during a subsequent period of potential
14 inflation seems in part to have been responsible for timidity in the use
15 of monetary policy until recently. That fear, under present institu-
16 tional arrangements is partly justified. To attempt to reduce substan-
17 tially the supply of money during periods of inflation through ordinary
18 central banking techniques -- which are techniques which operate
19 largely through the narrow channel of the securities market -- would
20 impose a strain on the financial markets reminiscent of the "financial
21 crises" in the New York market of past decades.

22 But the problem could be solved by the Government of Canada build-
23 ing up a cash surplus during periods of inflation and leaving that sur-
24 plus idle on deposit with the chartered banks. This is not only a matter
25 of surplus budgeting; it is also a matter of disposition of the surplus.
26 Disposition in the way suggested would in effect constitute a reduction
27 in the supply of money; it would result in fiscal policy reducing not only
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Monetary policy has been too inflexible in the sense that the range between monetary ease and monetary restriction within which it has operated over the business cycle has been too narrow. The fact that no one knows what constitutes the "right" supply of money at any given moment may lead to an overly cautious policy. The problem would be reduced if the central bank felt confident that mistakes could easily be remedied. The fear that substantial monetary expansion during recession will be difficult to offset during a subsequent period of potential inflation seems in part to have been responsible for timidity in the use of monetary policy until recently. That fear, under present institutional arrangements is partly justified. To attempt to reduce substantially the supply of money during periods of inflation through ordinary central banking techniques -- which are techniques which operate upon a strain on the financial markets reminiscent of the "financial crises" in the New York market of past decades.

But the problem could be solved by the Government of Canada building up a cash surplus during periods of inflation and leaving that surplus idle on deposit with the chartered banks. This is not only a matter of surplus budgeting; it is also a matter of disposition of the surplus. Disposition in the way suggested would in effect constitute a reduction in the supply of money; it would result in fiscal policy running not only



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3 disposable income but general public liquidity as well. Such an arrange-
4 ment would permit the Bank of Canada to act more decisively during a
5 recession than it has been able to do in the past. Through its control of
6 the supply of money the Bank of Canada could concentrate on creating
7 interest rate levels which it regarded as appropriate for the economic
8 circumstances of the time; while at the same time the budget would be
9 rendering decisive assistance to monetary policy in controlling the
10 stock of liquid assets of the public. Comprehensive aggregate stabiliza-
11 tion policy must include control of the cost of credit and of the stock of
12 liquid assets.

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14 RECOMMENDATION:

15 During a period of threatening demand inflation a policy of credit
16 restraint on the part of the Bank of Canada should be accompanied by
17 a policy of liquidity restriction on the part of the Government of Canada
18 through accumulation of idle government balances with the chartered
19 banks. During a period of unemployment a policy of credit ease on the
20 part of the Bank of Canada should be accompanied by a policy of liquidity
21 expansion on the part of the Government of Canada through the latter
22 financing its deficit at least in part out of previously accumulated cash
23 balances.

24 It is our view that the facilities available to the Bank of Canada for
25 controlling bank cash through open market operations and through
26 shifting Government of Canada funds between the Bank of Canada and
27 the chartered banks are adequate for central bank cash management.

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3 The use of techniques such as variable cash reserve ratios would,
4 in the Canadian institutional arrangement, be a warning that unusual
5 forces are tampering with prudent cash management. We see no
6 reason for adding to such techniques, in the form of a system of
7 "special deposits". Nor do we feel that any system of selective
8 credit controls should be the responsibility of the central bank.

9 (c) Undesirable Impact on the Capital Market

10 There have been occasions when the operations of the Bank of
11 Canada in its role of money manager and of agent of the govern-
12 ment for the management of the public debt have created unde-
13 sirable confusion and uncertainty in the financial markets. It
14 is not our view that a solution to this problem lies in confining
15 the Bank of Canada to one part of the financial market -- for
16 example, the short-term market, or in establishing yet another
17 authority, this one for managing the public debt. We believe it
18 lies in improving the lines of communication between the market
19 and those responsible for monetary and debt management, and
20 in making it possible for the Department of Finance and the
21 Bank of Canada to recruit and retain personnel whose technical
22 competence in trading and in the new issues market compares
23 favourably with any in the bond houses. There are various ways
24 that this might be done and no specific recommendation will be
25 suggested. But the possibilities that might be examined are
26 (1) one Deputy Governor of the Bank of Canada might always
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3 be appointed from the executive ranks of the financial
4 institutions for a period of three to five years without
5 being eligible for re-appointment except to another
6 position in the Bank; (2) the Bank of Canada might
7 assign more senior representatives to Toronto and
8 Montreal with more authority in trading than is now
9 the case; (3) the Board of the Bank of Canada might
10 include more members with financial and economic
11 experience than is now the case; (4) the Government
12 of Canada might request the financial institutions to
13 form a permanent advisory board which it could con-
14 sult whenever this seemed desirable.

15 One aspect of the relationship between Bank of
16 Canada, government, and financial market is worthy
17 of special attention. It is sometimes suggested that
18 the Bank of Canada, since its policy must be govern-
19 ment policy, should become a department of govern-
20 ment or a part of the Department of Finance. We
21 disagree. It is our view that the success of the Bank
22 of Canada in its money and debt management opera-
23 tions will depend to a significant degree on the extent
24 to which it can become a market institution as well
25 as an institution of economic policy. This, in our
26 view, is more likely to be the case if it operates as
27 a separate entity than if it does not.
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2 It is our view that one of the reasons why central bank
3 policy and operations are not widely understood and
4 occasionally somewhat emotionally misunderstood, is
5 the Bank of Canada's reluctance to discuss the rationale
6 of its operations and its policy, or even to announce
7 what its major policy decisions have been. It should
8 be possible for the Bank of Canada to be more forth-
9 coming in this respect without jeopardizing its role as
10 money and debt manager, without violating its subsidiary
11 relationship with the government of the day, and without
12 raising controversies which are not obviously related
13 to central banking. Such a procedure, we believe, might
14 also provide a solution to the perennial complaint of cen-
15 tral bankers that the public expects too much from mone-
16 tary policy.

17 (d) The "floating" Bank Rate

18 The financial operations of the Government of Canada
19 and the Bank of Canada are now so large and so influential
20 that they can have a decisive, sometimes devastating effect
21 on the smooth functioning of the capital market. It is not
22 idle curiosity which leads the banks, bond dealers, and
23 even other financial institutions to examine most carefully
24 the weekly statistics of the Bank of Canada and the statistics
25 relating to the financial position of the Government of Canada.
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2 Constant reassurance as to the basic direction of
3 official policy is necessary. This reassurance can
4 be given to a degree by a fixed Bank Rate, whereas
5 a floating rate is virtually meaningless. The fixed
6 Bank Rate is also a technique which on occasion can
7 be used to influence market expectations in an econ-
8 omically stabilizing manner; if for example, a
9 sudden increase in interest rates is necessary
10 because of an unexpected change in economic condi-
11 tions, a decisive increase in Bank Rate will harness
12 expectations to bring about the desired effect, an
13 effect which in subsequent weeks can be made per-
14 manent by a persistent policy of cash restraint. A
15 change in a fixed Bank Rate may also in time induce
16 some of the rather rigid institutional interest rates,
17 such as the chartered banks savings deposit rate, to
18 become more flexible. Public discussion of monetary
19 policy which in the past followed a change in Bank Rate
20 was not always constructive, but we believe that it
21 would become more constructive as time went on. It
22 is not our view that a fixed Bank Rate is a major
23 technique of central banking. Nonetheless, it is our
24 view that the effectiveness of the central bank would
25 be enhanced if it made use of that technique.
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2 RECOMMENDATION:

3 The Bank of Canada should revert to the practice of announcing a
4 fixed Bank Rate.

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6 (e) The 6% Ceiling on Chartered Bank Loan Rates

7 A ceiling on loan rates is justified if it is felt that the financial
8 institutions involved enjoy a monopoly or if it is thought that
9 the borrower must be protected against his own folly. When
10 the ceiling is so low that it at times fails to reflect the true de-
11 mand and supply forces in the capital market then it leads to
12 distortions in lending which are difficult to justify. In addition,
13 if it results in depositors being paid a relatively low return on
14 their funds, it also encourages a movement out of savings de-
15 posit balances and in that way reduces the effectiveness of
16 monetary policy. The interests of the borrower would be
17 satisfied if he was made aware of the costs of funds supplied
18 to him -- providing of course that he is not faced with a
19 monopoly lender. These are the principal considerations
20 leading us to the following recommendation:

21 RECOMMENDATION:

22 The 6% ceiling on chartered bank loans should be removed and the
23 borrower's copy of the loan contract or promissory note should bear
24 the simple annual rate of interest, to the nearest percent, being charged.
25 In addition, the Canadian Bankers' Association should play no part in the
26 determination of the prime loan rate or savings deposit rates. Informa-



tion on rates being charged and paid should be reported in convenient form to the Inspector-General of Banks.

(f) The Control of Non-Bank Financial Intermediaries

It has frequently been suggested that the powers of the Bank of Canada should be extended to include control over financial institutions other than the chartered banks because of the importance of those institutions in dispensing credit. We wish to discuss this issue at some length for its implications are important both for credit control and for the functioning of the institutions in the capital market.

Banks and non-bank financial institutions do not differ in that one can produce multiple expansion of credit and the other cannot; they both can do so. The banks can do so because they work to a cash/deposit ratio, provided they are given more cash by the central bank -- a side effect being an expansion in the supply of money, i. e. in deposit liabilities of the banks; and non-bank institutions might be thought of as doing so by working to some customary equity to debt ratio or liquid asset to liabilities ratio, and by increasing both the numerator and the denominator of that ratio by selling their equity or debt instruments to the general public -- a side effect being an increase in velocity of money, i. e. in chartered bank deposit liabilities.



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3 They are also the same in that both can increase the velocity
4 of medium of exchange by selling their more liquid assets to
5 holders of cash balances and using the proceeds to make loans
6 or purchase other securities.

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8 The two differ in that the banks, in the absence of central
9 bank control, could expand credit to the point where price
10 inflation caused people to lose confidence in bank deposits
11 i. e. the nation's money or medium of exchange; whereas
12 non-bank financial intermediaries could profitably expand
13 credit only so long as their cost of additional funds, which
14 would increase as they attempted to sell more and more of
15 their liability instruments (e. g. notes, debentures, time
16 deposits), was below the return on new assets they acquired.

17 Control of the chartered banks, or any other financial insti-
18 tution whose liabilities constituted acceptable media of ex-
19 change, would be necessary even if there was no business
20 cycle; control over non-bank financial intermediaries might
21 be justified if it could be shown that existing monetary tech-
22 niques operating on rates of interest were unable to narrow
23 the spread between return on assets and cost of funds, or
24 at least were unable to do so sufficiently quickly for anti-
25 cyclical purposes.
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They are also the same in that both can increase the velocity of medium of exchange by selling their more liquid assets to holders of cash balances and using the proceeds to make loans or purchase other securities.

The two differ in that the banks, in the absence of central bank control, could expand credit to the point where price inflation caused people to lose confidence in bank deposits, i.e. the nation's money or medium of exchange; whereas non-bank financial intermediaries could profitably expand credit only so long as their cost of additional funds, which would increase as they attempted to sell more and more of their liability instruments (e.g. notes, debentures, time deposits), was below the return on new assets they acquired.

Control of the chartered banks, or any other financial institution whose liabilities constituted acceptable media of exchange, would be necessary even if there were no business cycle, control of non-bank financial intermediaries might be justified if it could be shown that existing monetary restrictions operating on rates of interest were unable to narrow the spread between return on assets and cost of funds, or at least were unable to do so sufficiently quickly for anti-



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3 It is our view that existing monetary control techniques
4 can influence credit expansion of non-bank financial
5 intermediaries. By causing interest rates to rise to
6 the point where fewer and fewer borrowers find it
7 profitable to borrow, the central bank can establish a
8 ceiling on the return on new assets acquired by non-
9 bank financial intermediaries; while any persistent
10 attempt on the part of those financial intermediaries
11 to seek more and more funds for lending will increase
12 their cost of funds and this finally to the point where
13 return on new assets and cost of new funds are such as
14 to leave no room for additions to profits.

15 But does this process work sufficiently quickly for
16 purposes of credit control? We believe it does in most
17 cases provided the central bank influences interest rates
18 with determination; many non-bank financial intermediaries
19 have not shown volatile growth over the business cycle.
20 It does appear as if some financial intermediaries have
21 shown substantial expansion over certain past business
22 cycles. A part of that expansion in the past has resulted
23 from innovations in the capital market, such as the once-
24 for-all development of the short-term money market, but
25 such once-for-all developments do not justify added con-
26 trols in future.
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can influence credit expansion of non-bank financial

institutions. By causing interest rates to rise to

the point where fewer and fewer borrowers find it

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bank financial institutions, while any persistent

attempt on the part of those financial institutions

to seek more and more funds for lending will increase

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to leave no room for additions to growth.

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shown substantial expansion over certain past business

cycles. A part of that expansion in the past has resulted

from innovations in the capital market, such as the intro-

duction of the short-term money market, but

even once these developments do not justify added con-

trol in the future.



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3 Some of it we believe has resulted from the fact that the
4 financial intermediaries involved may be catering to types
5 of borrowers who for rational or irrational reasons are
6 exceedingly insensitive to the cost of credit during periods
7 of economic expansion, and not because those financial
8 intermediaries are able to obtain large quantities of funds
9 for relending without suffering significant increases in the
10 rate of interest they have to pay. To impose controls on
11 those financial institutions would not get at the root of the
12 trouble which is the insensitivity of their customers to
13 rates of interest, and would merely drive those customers
14 elsewhere for the funds they feel they must have. The
15 solution to the problem we feel lies in influencing directly
16 those sectors which tend to be insensitive to rates of in-
17 terest, and emergency techniques for this purpose we
18 discuss in the next subsection of this Submission.

19 While statistical data which we would wish to have in
20 order to form a final view on the issue discussed above,
21 is not available, we wish to emphasize that logic alone
22 does not lead to the conclusion that non-bank financial
23 intermediaries should directly be controlled for anti-
24 cyclical purposes, and whatever evidence we have seen
25 leads us to believe that they should not be so controlled.
26 We would therefore recommend the following:
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RECOMMENDATION:

Direct controls for purposes of economic stabilization should not be imposed on those non-bank financial intermediaries whose liability instruments do not to any significant degree constitute media of exchange.

(2) Techniques for controlling particularly volatile spending sectors of the economy

In an earlier part of this Submission we suggested that there have been times when business capital spending and consumer spending on durable goods have been unusually volatile over the business cycle and that such volatility may reflect an insensitivity to interest rates under certain economic circumstances. If this is a correct interpretation of the facts then we should have control techniques which would supplement interest rates in influencing the return which businessmen expect to obtain from new capital expenditures, and supplement the interest deterrent to excessive demand for consumer credit. We wish to emphasize that such emergency techniques should remain supplementary to aggregate monetary and fiscal policy for we do not expect that they would be required in every business cycle; but also, we believe that they should be available at short notice because of the unpredictability of the unfolding nature of the business cycle and economic growth.

Direct controls for purposes of economic stabilization should not be imposed on those non-bank financial intermediaries whose liability instruments do not to any significant degree constitute media of ex-

(2)

Structure of the economy

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3 Of the various techniques that might be considered
4 we believe that the most effective and most suitable
5 one for exercising a supplementary influence on
6 business capital spending is flexible variation of
7 depreciation allowances on new investment in terms
8 both of the length of the write-off period and of the
9 proportion of the total cost that can be written off;
10 and the most effective one for exercising a supple-
11 mentary influence on consumer spending on durable
12 goods is variation of down-payment and period-of-
13 repayment requirements.

14 RECOMMENDATION:

15 Variation of depreciation allowances for purposes of computing
16 federal income tax liabilities should be put on a statutory basis in a
17 way which would permit their flexible use by the Minister of Finance
18 for anti-cyclical purposes; and if possible ways and means should be
19 found to vary down-payment and repayment provisions of all consumer
20 credit contracts in an anti-cyclical manner.

21
22 (3) Techniques for increasing the mobility of labour and
23 capital between the public and private sectors of the
24 economy

25 Earlier in this submission we referred to the fact that
26 some economic instability is likely to remain in the
27 private sector of the economy even after the conscien-
28 tious use of stabilization techniques, and that as long
29
30

Of the various techniques that might be considered, we believe that the most effective and most suitable one for exercising a supplementary influence on business capital spending is flexible variation of depreciation allowances on new investment in terms both of the length of the write-off period and of the proportion of the total cost that can be written off, and the most effective one for extending a supplementary influence on consumer spending on durable goods is variation of down-payment and period of repayment requirements.

Variation of depreciation allowances for purposes of computing total income tax liabilities should be set on a statutory basis in a way which would permit their flexible use by the Minister of Finance for anti-cyclical purposes; and if possible ways and means should be found to vary down-payment and repayment provisions of all consumer credit contracts in an anti-cyclical manner.

(3) The object of increasing the mobility of labour and capital between the public and private sectors of the

Further in this submission we referred to the fact that some economic instability is likely to remain in the private sector of the economy even after the correction from use of anti-cyclical techniques, and that as a



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2
3 as this is the case it will be desirable for resources
4 to move in and out of the public sector of the economy
5 in a cyclically stabilizing manner. We believe that
6 fiscal policy of the federal government alone is in-
7 sufficient to effect the required shift, that frequently
8 the highly productive social capital projects are ones
9 for which the provinces and municipalities are finan-
10 cially responsible. It is our view that improvement
11 in the anti-cyclical use of capital expenditures in the
12 public sector requires co-ordination of such spending
13 of all levels of government, and that this is possible
14 within the framework of a federal constitution. There
15 is evidence that some provincial authorities are not
16 averse to the concept of cyclical budgeting, and
17 given leadership in the matter by the federal govern-
18 ment there is a reasonable hope that through co-operation
19 and consultation alone, the rate of capital spending which
20 is under the control of the provinces could more effect-
21 ively be varied for stabilization purposes than has been
22 the case in the past.

23 RECOMMENDATION:

24 The Government of Canada should take the initiative in developing
25 lines of communication between it and the provinces which would per-
26 mit continuous consultation and co-operation with respect to apprais-
27 ing the social capital needs of the nation and the planning and execu-
28 tion of public capital expenditure programmes.
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as this is the case it will be desirable for resources to move in and out of the public sector of the economy in a cyclically stabilizing manner. We believe that fiscal policy of the federal government alone is insufficient to effect the required shift, that frequently the highly productive social capital projects are those for which the provincial and municipal authorities are financially responsible. It is our view that improvements in the anti-cyclical use of capital expenditures in the public sector requires co-ordination of such spending of all levels of government, and that this is possible within the framework of a federal constitution. There is evidence that some provincial authorities are not averse to the concept of cyclical budgeting, and given leadership in the matter by the federal government there is a reasonable hope that through co-operation and consultation of the rate of capital spending which is under the control of the provinces could more effectively be varied for stabilization purposes than has been the case in the past.

The Government of Canada should take the initiative in developing lines of communication between it and the provinces which would permit continuous consultation and co-operation with respect to planning the social capital needs of the nation and the planning and execution of public capital expenditure programmes.



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3 (4) Techniques for improving the flow of information to the
4 private sector of the economy so as to reduce instability
5 arising from business decisions based on incorrect or
6 incomplete information

7 There are two areas where additional information
8 would, we believe, be useful for this purpose: the
9 size of productive capacity in industry, and the nature
10 of behaviour of inventories. It is possible that periodic
11 construction of excess capacity would be dampened if
12 at all times there was general awareness of the existing
13 state of capacity in industry and if from the earlier
14 stages of cyclical expansion capital spending intentions
15 were related to changing industrial capacity. The statis-
16 tical difficulties in compiling the information are great;
17 nonetheless we would recommend the following:

18 RECOMMENDATION:

19 The Government of Canada should make it possible for the Dominion
20 Bureau of Statistics and the Department of Trade and Commerce to
21 attempt to expand the annual survey of investment intentions to include
22 an annual survey of utilization of productive capacity.

23
24 Instability in the behaviour of inventories may arise in part be-
25 cause individual businessmen are insufficiently aware of the movements
26 in their own inventories and because individual businessmen are in-
27 sufficiently aware of the behaviour of inventories in their industry as a
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3 whole. Techniques for inventory management at the company level have
4 improved greatly in recent years, but they could be adopted more widely
5 than appears to be the case at present; and seasonally adjusted series of
6 inventories on the industry level might be extended to cover more indus-
7 tries and might be published more quickly than is now the case.

8
9 RECOMMENDATION:

10 The Government of Canada, probably through the Department of
11 Trade and Commerce, should take positive steps to encourage wide
12 adoption of formal inventory control measures at the company level;
13 and should improve the statistical documentation of inventory behaviour
14 on the industry level.

15 (5) Techniques for dealing specifically with "cost-push" inflation

16
17 RECOMMENDATION:

18 The proposed economic stabilization board or committee should
19 develop statistics on labour productivity and product prices which
20 could serve as guides to wage settlements and pricing policies in in-
21 dustries where it seems likely that monopoly elements are significant
22 on one or both sides of the bargaining table.

23 It is quite possible that experience would show that further steps would
24 need to be taken to meet the problem, but this would appear to us to
25 constitute a reasonable starting point.
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3 (6) Techniques for ensuring that the cost imposed on individuals
4 by economic instability which it has not been possible to re-
5 move are spread equitably throughout the economy.

6 The principal contribution of the policy maker in this respect
7 must come from the "built-in stabilizers" of fiscal policy, of
8 which unemployment insurance is the most important. It does
9 not appear that additional techniques of a cyclically stabilizing
10 character which also serve the above mentioned purpose are
11 readily available, and if it is found that this purpose is not
12 sufficiently being served an extended use of existing techniques
13 would probably prove to be adequate.

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PART TWO

FUNCTIONING OF THE CAPITAL MARKET

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5 It would be difficult to over-emphasize the importance to a market-
6 oriented economy of a freely and efficiently functioning capital market.
7 In a very real sense of the word the capital market lies at the heart of
8 such an economy because of its role in allocating the nation's capital to
9 various and competing uses.

10
11 Our capital market is by no means without deficiencies. What
12 one's reaction is to such deficiencies, what solutions one attempts to
13 devise for improving the functioning of the capital market will no doubt
14 be influenced by one's over-all impression of the performance of the
15 market as compared with the likely performance of other systems for
16 allocating the nation's capital.

17
18 Our own general impression is that much of the capital market
19 functions smoothly and relatively efficiently. Where there are defic-
20 iencies two types of solutions should be considered: those which re-
21 move the deficiency by removing the obstacles which interfere with
22 the smooth functioning of the market; and in cases where that is not
23 possible, those which supplant the operation of the market in particular
24 areas, through the introduction of government credit institutions or the
25 introduction of regulations affecting the operations of private credit in-
26 stitutions. It is also our view that the former solution should be given
27 serious consideration before the latter is resorted to, since we believe

FUNCTIONING OF THE CAPITAL MARKET

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3 that while our capital market has undergone and is undergoing sub-
4 stantial change, it should and will to a very substantial degree con-
5 tinue to be based on the inter-play of competitive forces.

6 In this section of our submission we shall be concerned with a
7 number of specific issues relating to the functioning of the capital
8 market in general. The issues discussed are not always related
9 to each other; nor do they by any means constitute a comprehensive
10 list of the "problem" areas of the capital market. They are merely
11 issues which we happen to have encountered and upon which we have
12 views which might be of interest to the Commission.

13 The problems that will be discussed are not ones about which
14 we feel we are competent to make definite recommendations, and
15 therefore we prefer to leave our views in the form of "suggestions".
16

17 (1) Competition

18 The history of the development of the Canadian capital
19 market reveals a number of examples where new and
20 more efficient capital market institutions have proved
21 to be the decisive competitors of existing and less
22 efficient ones. Effective competition is desirable not
23 merely for helping to maintain efficiency among exist-
24 ing companies in the capital market, but also for en-
25 couraging the further development of the market.

26 Therefore market practices, institutional arrange-
27 ments, and legislative restraints which dampen this
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that while our capital market has undergone and is undergoing substantial change, it should and will to a very substantial degree continue to be based on the inter-play of competitive forces.

In this section of our submission we shall be concerned with a number of specific issues relating to the functioning of the capital market in general. The issues discussed are not always related to each other; nor do they by any means constitute a comprehensive list of the "problem" areas of the capital market. They are merely issues which we happen to have encountered and upon which we have views which might be of interest to the Commission.

The problems that will be discussed are not ones upon which we feel we are competent to make definite recommendations, and therefore we prefer to leave our views in the form of "suggestions".

The history of the development of the Canadian capital market reveals a number of examples where new and more efficient capital market institutions have grown to be the decisive competitors of existing and less efficient ones. Efficient competition is desirable not merely for its own sake but for its effect in promoting efficiency among existing companies in the capital market, but also for encouraging the further development of the market. Therefore market practices, institutional arrangements, and legislative enactments which shape this



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2 competition not only reduce the spur to efficiency
3 among existing companies operating in the capital
4 market, but also reduce the rate of improvement
5 of the capital market over time.

6
7 The relationship between some banks and some trust companies,
8 through equity ownership and directorships, is very close. This re-
9 lationship is a respectable one in the sense that it has existed
10 virtually, but not quite, since the beginning of the formation of trust
11 companies in Canada. What has changed is that the trust companies
12 have in recent years become more venturesome. Some of this
13 venturesomeness has taken the form of competition with the banks
14 and in several cases even with the mutual funds. We enthusiastically
15 endorse this development and hope it will go further.

16 There is, however, the question whether the close ties between
17 banks and trust companies which were largely formed under quite
18 different conditions -- including less concentration in banking -- are
19 desirable under present conditions. We believe that a case could be
20 made for prohibiting the banks from owning more than a nominal
21 amount of the equity of a particular trust company, and for prohibit-
22 ing directors of trust companies from also being directors of the
23 chartered banks. Conditions should be such as to enable trust com-
24 panies over the span of years to become even more competitive with
25 banks and other financial institutions than is now the case.

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3 There is also the matter of amalgamations and mergers in the
4 capital market. Again the history of Canada's capital market provides
5 some key to desirable developments in future. There is some evidence
6 that the most efficient size of a given financial intermediary is likely to
7 be one which constitutes a significant portion -- perhaps in the area of
8 20% -- of the combined size of all financial institutions of that type. In
9 some cases the pattern of historical development has been a great
10 proliferation of companies when a new type of institution first appears
11 and then a persistent decline in the number of companies or in the
12 number of companies which account for a large part of the total size
13 of institutions of a particular type. It would, therefore, be a mistake
14 to regard all mergers and amalgamations as undesirable.

15 For example, it does not appear to us to be in the public interest
16 for the largest chartered banks to be permitted to amalgamate with
17 other chartered banks, but an amalgamation between the very small
18 chartered banks might be desirable. Also, we believe that further
19 amalgamations among trust companies would not be undesirable,
20 although whether such amalgamations should involve the several
21 very large trust companies is another matter. In general we suggest
22 that a distinction should be made between amalgamations which in-
23 crease further the share of the market of the large financial institu-
24 tions and those which do not. It is perhaps desirable and possible to
25 devise formulae which would prevent the former without prohibiting
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There is also the matter of amalgamations and mergers in the capital market. Again the interest of Canada's capital market provides some key to desirable developments in future. There is some evidence that the most efficient size of a given financial institution is likely to be one which constitutes a significant portion -- perhaps in the area of 50% -- of the combined size of all financial institutions of that type. In some cases the pattern of financial development has been a great proliferation of companies as when a new type of institution first appears and then a persistent effort to the number of companies in the number of companies which account for a large part of the total size of institutions of a particular type. It would, therefore, be a mistake to regard all mergers and amalgamations as undesirable.

For example, it does not appear to me to be in the public interest for the largest chartered banks to be permitted to amalgamate with other chartered banks, nor an amalgamation before a very small chartered bank might be desirable. Also, we believe that further amalgamations among trust companies would not be undesirable, although whether such amalgamations should involve the merger of very large trust companies is another question. In general we suggest that a distinction should be made between amalgamations which are created further the closer to the heart of the large financial institutions and those which are not. It is perhaps desirable and possible to devise formulas which would prevent the former without prohibiting



1 the latter, even though this would involve co-operation between the
2 federal and provincial authorities.

3
4 (2) The Short-Term Money Market

5 In a relatively few years the short-term money market
6 in Canada has grown substantially in the volume of busi-
7 ness it does and in the variety of paper it handles. There
8 are only two aspects of this development to which we
9 wish to refer: the number of bond dealers in the market,
10 and the scrutiny of the paper which comes into the market.

11 While the market has grown substantially its size would
12 still not really seem to justify the relatively large num-
13 ber of dealers that are members of it. We, however, do
14 not believe that the number should artificially be restricted.
15 But it may be that if all the money market dealers were re-
16 quired to meet higher minimum standards in their role of
17 "jobbers" of money market instruments that the matter
18 would take care of itself. We wonder therefore whether
19 the Bank of Canada should not restrict its "repurchase"
20 facilities to those dealers that fulfill adequately their
21 role of "jobbers" in money market securities.

22
23 Historically short-term loans in Canada have come from
24 the chartered banks. Now through the growing importance
25 of finance company and commercial paper some of them
26 also come from the money market. Over the years the
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the latter, even though this would involve co-operation between the
federal and provincial authorities.

In a relatively few years the short-term money market
in Canada has grown substantially in the volume of business
and it does not in the variety of paper it handles. There
are only two aspects of this development to which we
wish to refer: the number of bank dealers in the market,
and the securing of the paper which comes into the market.

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still not really seem to justify the relatively large number
of dealers that are members of it. We, however, do
not believe that the number should artificially be restricted.
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Historically short-term loans in Canada have come from
the chartered banks. Now through the growing importance
of finance companies and commercial paper some of them
also come from the money market. Over the years the



1 banks have come to develop techniques for scrutinizing
2 closely the credits which they approve. We wonder
3 whether this is happening to the credits approved by
4 the money market dealers or by the investors in money
5 market instruments. It appears that in some cases
6 substantial reliance is placed on the short-term
7 borrower having an unused line of credit with a bank
8 -- a line of credit which under conditions of restraint
9 might suddenly become precarious. Several defaults
10 in the redemption of short-term paper might result
11 in a severe set-back to the further development of the
12 money market.

13
14 It may therefore be desirable for requiring all recog-
15 nized money market dealers to outline their procedures
16 for appraising credit risks before they are granted
17 borrowing facilities by the Bank of Canada. In addition,
18 while we do not wish to discuss formation of a market
19 in bankers' acceptances, we do believe that such a
20 market among other things would result in money mar-
21 ket instruments receiving closer scrutiny than appears
22 now to be the case.

23
24 (3) Equity Ownership in Canada

25 It is sometimes suggested that the reason why Canadian
26 companies have drifted into foreign ownership is because
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banks have come to develop techniques for scrutinizing closely the credits which they approve. We wonder whether this is happening to the credits approved by the money market dealers or by the investors in money market instruments. It appears that in some cases substantial reliance is placed on the short-term borrower having an unused line of credit with a bank -- a line of credit which under conditions of restriction might suddenly become precarious. Several defaults in the redemption of short-term paper might result in a severe set-back to the further development of the

it may therefore be desirable for regulating all recognized money market dealers to outline their procedures for appraising credit risks before they are granted borrowing facilities by the Bank of Canada. In addition, while we do not wish to discuss formation of a market in bankers' acceptances, we do believe that such a market among other things would result in money market instruments receiving closer scrutiny than appears now to be the case.

Equity Ownership in Canada

(3)

It is sometimes suggested that the reason why Canadian companies have drifted into foreign ownership is because



1 Canada has insufficient capital of that kind. We
2 disagree. We suspect it is in part because of the
3 overly-conservative investment practices of our
4 institutional investors, particularly our life in-
5 surance companies, and perhaps also because of
6 inadequate capital of Canadian underwriting houses
7 as a group.

8
9 Taking the first point first, we wonder whether almost
10 a century of supervision by the Department of Insurance,
11 coupled with the distorting views on investment values
12 created by the depression of the 1930's have not resulted
13 in a serious decline in the venturesome character of life
14 insurance investment practices. Is it possible that the
15 end result of those institutions operating under the cau-
16 tious eye of the government supervisor and of knowing
17 that mistakes will to some extent appear for all to see
18 in published returns, is that the the investment boards
19 of such companies have finally become more cautious
20 than the official supervisors? We do not know, but
21 suggest that ways should be found to make it respectable
22 for life insurance companies to take greater risks than
23 they now do, and to make individual investment mistakes
24 which, while known to the Departments of Insurance, are
25 not as a matter of course made known to the world at
26 large through official publications.

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Canada has itself been a party to the
dispute. It is a matter of the
overly-conscious interest of the
institutional movement, and the

reputation of the country is at stake.
The group.

During the first part of the
a feeling of uneasiness by the Department of
connected with the question of the
acted by the Department of the
in a narrow circle in the
then more important than the
and result of these institutions
these are of the Government
that resulted with the
in political terms, it is the
of each institution and the
than the national government. We
organism and it is the
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not as a matter of course
large through official



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3 It is virtually impossible for an "outsider" to
4 appraise the adequacy of the capital of Canada's
5 underwriting houses as a group. If it was in-
6 adequate one result would be for them to be
7 rather more cautious in assuming risky under-
8 writing liabilities than if it was not. For
9 example, to offer the stock of a new public
10 company to Canadians instead of permitting
11 old established private companies from being
12 sold to foreign investors, might require the
13 underwriters to retain a significant portion
14 of the stock for an extended period of time.

15 This is possible only if the underwriters have
16 sufficient capital. It may, therefore, be that
17 the operation of the capital market would be
18 improved if say, Canadian life insurance
19 companies were permitted to assume under-
20 writing liabilities in Canada. Some Canadian
21 life companies already, in effect, assume such
22 liabilities in the City of London, England.

23 This may also be the appropriate place to refer
24 to the occasional practice of the chartered banks
25 to engage in term lending. Such lending has
26 several times suffered the disapproval of the
27 Bank of Canada. We would suggest that as a
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it is virtually impossible for an "outsider" to appraise the adequacy of the capital of Canada's underwriting houses as a group. If it was inadequate one result would be for them to be rather more cautious in assuming risky underwriting liabilities than if it was not. For example, to offer the stock of a new public company to Canadian's instead of permitting old established private companies from being sold to foreign investors, might require the underwriters to retain a significant portion of the stock for an extended period of time. This is possible only if the underwriters have sufficient capital. It may, therefore, be that the operation of the capital market would be

companies were permitted to assume underwriting liabilities in Canada. Some Canadian life companies already, in effect, assume such liabilities in the City of London, England.

This may also be the appropriate place to refer to the occasional practice of the chartered banks to engage in term lending. Such lending has several times suffered the disapproval of the Bank of Canada. We would suggest that as a



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3 matter of long-run practice it is highly desirable.
4 In special cases it is the most efficient way for
5 capital to be raised; at the same time bank assets
6 are so large and the banks have such a high pro-
7 portion of savings deposits in their liabilities
8 that they can make loans of that kind without any
9 significant impairment of their financial soundness.

10 There is also the matter of the flow of new equity
11 issues. Tax laws discourage companies from
12 raising funds through the sale of stock, and en-
13 courage them to finance through the sale of debt.
14 Yet there is no obvious reason why such distortion
15 is necessary or desirable. It is possible that an
16 improvement would be for neither interest nor
17 dividends to be a deductible expense for income
18 tax purposes and for the resulting increase in
19 the burden of taxation to be neutralized by an
20 offsetting reduction in the rate of corporation
21 income tax.

22
23 (4) Municipal Debenture Financing

24 Considerable concern has been expressed over the
25 adequacy with which the financial markets are pro-
26 viding municipalities with the funds they require. In
27 our view it would be a mistake to assume too readily
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matter as long-run practice it is hardly desirable
in special cases it is the most efficient way for
capital to be raised at the same time back assets
are so large and the banks have a high pro-
portion of savings deposits in their portfolios
that they can make loans of that kind without any
significant impairment of their financial soundness.

There is also the matter of the flow of new equity
funds. Tax law discourages companies from
raising funds through the sale of stock, and en-
courages them to finance through the sale of debt.
Yet there is no obvious reason why such distinction
is necessary or desirable. It is possible that an
improvement would be for neither interest nor
dividends to be a deductible expense for income
tax purposes and for the resulting increase in
the burden of taxation to be partly met by an
offsetting reduction in the rate of corporation
income tax.

(4)

Consequently concern has been expressed over the
adapting with which the financial markets are pro-
viding a market for the new issues of securities. In
our view it would be a mistake to assume too readily

1
2 that an inadequacy of funds was the result of the
3 malfunctioning of private capital market institu-
4 tions, although we do wish to refer to at least one
5 possible problem of that kind. The basic difficulty
6 may be the reluctance on the part of at least some
7 municipalities to raise tax rates to levels which
8 reflect the services demanded by their taxpayers;
9 and the inadequacy of municipal taxing powers. It
10 would, in our view, be a mistake to attempt to
11 devise new institutions or investment practices
12 for remedying what is essentially a problem of
13 fiscal policy.

14
15 At the same time we have gained the impression
16 that investment practices of some existing insti-
17 tutional investors are based on rules-of-thumb
18 which no longer are relevant. How long must a
19 municipality which experienced a bond default
20 in the 1930's as a result of economic forces over
21 which it had no control, pay for its "sins"? Also,
22 is there not a tendency for rates on smaller
23 municipal issues to vary directly with the distance
24 of those municipalities from Toronto and Montreal?
25 A dispassionate appraisal of the credit rating of
26 smaller municipalities would seem to have become
27 desirable.

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that an inadequacy of funds was the result of the malfunctioning of private capital market institutions, although we do wish to refer to at least one possible problem of that kind. The basic difficulty may be the reluctance on the part of at least some municipalities to raise tax rates to levels which reflect the services demanded by their taxpayers, and the inadequacy of municipal taxing powers. It would, in our view, be a mistake to attempt to devise new institutions or investment practices for remedying what is essentially a problem of

At the same time we have gained the impression that investment practices of some existing institutional investors are based on rules-of-thumb which no longer are relevant. How long must a municipality which experienced a bond default in the 1930's as a result of economic forces over which it had no control, pay for its "bonds"? Also, is there not a tendency for rates on smaller municipal issues to vary directly with the distance of those municipalities from Toronto and Montreal? A disproportionate appraisal of the credit rating of smaller municipalities would seem to have become a

1
2 It is suggested therefore that the Investment Dealers'
3 Association be encouraged to establish a rating sys-
4 tem for municipal issues which would serve as a
5 guide to the changing credit standing of municipalities.
6

7 The trend has been for provinces to assume some of
8 the burden of municipal financing, by extending loans
9 and grants to them, by guaranteeing municipal issues,
10 and by assuming responsibility for some of the services
11 traditionally provided by municipalities. There is
12 nothing undesirable about this trend but it is possible
13 that it could go too far. Municipal taxing powers and
14 practices, as well as institutional investment practices
15 and facilities for marketing municipal debenture issues
16 should be such as to maintain an economically healthy
17 and viable system of local government.

18 (5) Government Credit Institutions

19 As already mentioned it may on occasion be necessary
20 to fill gaps in the capital market with new government-
21 sponsored credit institutions. This raises the question
22 as to the basis of operation of those institutions. It is
23 possible to draw on historical experience to show that
24 government credit institutions can easily change from
25 their role of filling gaps to the one of supplanting or
26 competing with already existing institutions -- through
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It is suggested therefore that the International Development Association be encouraged to establish a rating system for municipalities which would serve as a guide to the spending account autonomy of municipalities.

The trend has been for provinces to assume more of the burden of municipal financing, by extending loans and grants to them, by guaranteeing municipal borrowings and by assuming responsibility for some of the services traditionally provided by municipalities. There is nothing undesirable about this trend but it is possible that it could go too far. Municipal taxing powers and procedures, as well as institutional investment procedures and facilities for marketing municipal debt issues should be such as to maintain an economically healthy and viable system of local government.

Government Owned Institutions

(5)

As already mentioned it may on occasion be necessary to fill gaps in the capital market with new government-sponsored credit institutions. This raises two questions as to the basis of operation of these institutions. It is possible to draw on historical experience to show that their role of filling gaps in the market or supplementing existing with already existing institutions or through

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3 advantages gained from enjoying a subsidized source
4 of external funds and a tax-free source of internal
5 funds. (With the growing importance of credit unions
6 this can apply also to them.) It cannot be assumed
7 that government sponsored credit institutions will
8 always allocate funds in an economically efficient
9 manner, and it cannot be assumed that if they do not
10 this will be reflected in their present form of balance
11 sheet.

12 It would seem desirable for such institutions to be
13 required to develop accounting techniques, and to
14 make information available to the interested public,
15 which would permit an "outsider" to form a view on
16 the adequacy with which they are fulfilling their
17 originally intended role.

18
19 (6) Continuing Improvement in the Capital Market

20 The functioning of our capital market is likely to
21 improve more quickly if deficiencies which arise
22 in it from time to time are quickly recognized and
23 speedily dealt with. We are concerned with how
24 little interest the Canadian Bankers' Association,
25 the Investment Dealers' Association, and the
26 Dominion Mortgage and Investments Association
27 appear to show to this aspect of the health of the
28
29
30

1
2
3 market, in contrast to the admirable work they
4 have done in other directions. Curiously enough
5 greater interest of this kind has recently been
6 shown by the Stock Exchanges, although the cynic
7 would no doubt remark that this was because they
8 have enjoyed and do enjoy the most room for im-
9 provement.

10 It might therefore be suggested to those Associations
11 that either separately or in co-operation with each
12 other they might begin to concern themselves with
13 the operation in general of the capital market, and
14 that they might express that concern by undertaking
15 or sponsoring studies, on a continuing basis, aimed
16 at improving the performance of the capital market.
17 The costs involved are likely to be small, the
18 rewards potentially very large.
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Royal Commission on Banking and Finance

SUPERINTENDENT OF INSURANCE

Hearings
held at
OTTAWA

Vol.

54

Date.

October 26, 1962



Official Reporters
J. J. Nethercut and R. J. Young
Toronto, Ont.



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Toronto, Ontario

ROYAL COMMISSION ON BANKING

AND FINANCE

Hearings held at Ottawa,
Ontario, on Friday,
October 26th, 1962.

THE COMMISSION

The Honourable Dana Harris Porter
Chief Justice of Ontario
Toronto, Ontario - Chairman

Mr. W. Thomas Brown, M.B.E.
Investment Dealer
Vancouver, British Columbia

Mr. James Douglas Gibson, O.B.E.
Banker
Toronto, Ontario

Mr. Gordon L. Harrold
Agriculturalist
Calgary, Alberta

Mr. Paul H. Leman
Corporation Executive
Montreal, Quebec

Mr. John C. MacKeen
Corporation Executive
Halifax, Nova Scotia

Dr. W.A. Mackintosh
Vice-Chancellor
Queen's University
Kingston, Ontario

Mr. H.A. Hampson - Secretary

Mr. Gilles Mercure - Joint Secretary



Ottawa, Ontario,
Friday,
October 26th, 1962.

--- At 9.15 A.M. the hearing commenced.

SUBMISSION OF THE
SUPERINTENDENT OF INSURANCE

APPEARANCES

Mr. K.R. MacGregor	- Superintendent of Insurance
Mr. R. Humphrys	- Assistant Superintendent of Insurance

THE CHAIRMAN: This morning we have a submission from the Superintendent of Insurance, Mr. MacGregor. I understand, Mr. MacGregor, that you wish to make a preliminary statement before we enter into our discussion.

MR. MacGREGOR: Mr. Chairman, and Commissioners, this is one assignment that I found rather difficult to prepare for in any great detail. In my submission to the Commission I endeavoured to outline very briefly the background of federal insurance legislation and jurisdiction, and also to touch briefly upon the other major fields with which the Department is connected.

As will be seen from the first page or two of the submission, our field is quite broad and I do not think there is any other government department, in any other country with which I am familiar, dealing with financial institutions, that covers

October 20, 1962

--- At 9:15 A.M. the hearing commenced

COMMISSION ON THE

INTERDEPENDENCY OF HUMANITY

Mr. K. R. McGovern
Chairman

Mr. K. R. McGovern

Mr. R. Kennedy
Vice Chairman
Mr. J. W. Fulbright
Mr. J. D. Eastland

Mr. R. Kennedy

THE CHAIRMAN: This morning we have a

submission from the Subcommittee of Insurance.

Mr. McGovern, I understand, Mr. McGovern, that

you wish to make a preliminary statement before

we enter into our discussion.

THE CHAIRMAN: Mr. McGovern, and Commissioner

this is one statement that I found rather difficult

to prepare for in any great detail. In my submission

to the Commission I referred to certain

briefly the background of Federal Insurance legislation

and taxation, and also to touch briefly upon

the other major fields with which the Department

is concerned.

As will be seen from the first page of

the submission, we think it is quite correct to

do not think there is any other government

entirely in any other country with which I am familiar.



1 quite as broad a field as we do.

2 In most countries supervision of insurance
3 companies, and perhaps some other similar kinds of
4 companies, may be carried on by one government
5 department, but the actuarial work for the government,
6 for example, is usually done by some other department.

7 In our case we occupy both fields; that
8 is to say, we do a great deal of the actuarial
9 work for the government and we supervise quite a
10 variety of companies. Not only is there variety in
11 the kind of companies that are supervised; that is
12 to say, insurance companies of all kinds, fraternal
13 benefit societies, loan and trust companies, small
14 loans companies, and money lenders licensed under
15 the Small Loans Act, and certain central co-operative
16 credit societies, but there is also a great deal
17 of variety in the native origin of the companies
18 supervised.

19 In the life insurance field, roughly two-
20 thirds of the business is done by native companies.
21 The other third is done by British and foreign
22 companies. Until 1955 or thereabouts all of the
23 companies from outside Canada transacting life
24 insurance were English speaking; that is to say,
25 they were from the United States, the United Kingdom,
26 and there was one from Australia.

27 Since 1955 we have had a few Swiss, Dutch
28 and German life companies enter the field.

29 In the fire and casualty insurance field,
30 however, the situation is just about the opposite.



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is to say, we do a great deal of the actuarial

work for the government and we supervise quite a

variety of companies. Not only is there variety in

the kind of companies that are supervised, but in

to say, insurance companies of all kinds, transport

benefit societies, loan and trust companies, etc.

loan companies, and money lenders licensed under

the Small Loans Act, and certain central co-operative

credit societies, but there is also a great deal

of variety in the nature of the companies

In the life insurance field, not only two-

thirds of the business is done by native companies.

The other third is done by British and foreign

companies. Until 1925 or thereabouts all of the

companies from outside Canada transacting life

insurance were English speaking; that is to say,

they were from the United States, the United Kingdom,

and there was one from Australia.

Since 1925 we have had a few Swiss, Dutch,

and German life companies enter the field.

In the fire and casualty insurance field,



1 Very considerably less than one-third of the business
2 is done by native companies controlled in Canada,
3 and the vast bulk of the fire and casualty business
4 in Canada is done by companies spread almost around
5 the globe.

6 In the loan and trust field we have a
7 situation where all of the companies are Canadian,
8 dominion or provincial, and we have none from outside
9 Canada.

10 In the small loans field the bulk of
11 the business is done by Canadian companies that are
12 subsidiaries of United States parent chains.

13 Then, again, in the co-operative credit
14 society field we have, of course, simply native
15 organizations: one dominion central and four
16 provincial centrals.

17 In my submission, apart from touching
18 very briefly upon the background of our work, I have
19 attempted to deal with a few points that arose in
20 the submissions of other organizations, either the
21 Canadian Life Insurance Officers' Association or
22 the Trust Companies Association of Canada, being
23 points that seemed to be of particular interest,
24 as, for example, the question of control of Canadian
25 life insurance companies, or certain amendments
26 that have been requested by the life insurance
27 companies that the Department could not support or
28 at least did not feel it was justified in supporting.

29 Also, in the case of the loan and trust
30 companies, a request has been made from time to time --

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is done by native companies controlled in Canada,
and the vast bulk of the fire and casualty business
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that have been requested by the life insurance
companies that the Department could not regard as
at least did not feel it was justified in responding.
Also, in the case of the loan and trust



1 and this was renewed in their brief -- that the limit
2 of their borrowing powers should be increased. I have
3 touched very briefly upon that point in my submission.

4 I have not, however, dealt at any length
5 with the central co-operative credit societies. They
6 too, in their brief, have suggested certain amendments,
7 about six I think, and I would welcome the opportunity
8 at some stage to comment upon those suggestions,
9 for I feel that the Department may have been put
10 in the position where it may appear to be impeding
11 the progress at least of the dominion central, and
12 I should like to explain the situation in that
13 particular respect.

14 I am in the hands of the Commissioners.
15 There were some other points that I noticed were
16 raised when the Canadian Life Insurance Officers'
17 Association presented their brief, that have not
18 yet been answered. I have certain data which I
19 believe would answer those questions. For example,
20 one Commissioner asked about the proportion of the
21 life business done in Canada today by those companies
22 that were on the scene 30 years ago, and some
23 other questions were asked concerning the number of
24 life insurance companies that have entered the
25 field during the last 30 years, the number that
26 have been withdrawn, and so on. I have certain
27 data with respect to these points that I should be
28 glad to give if the Commissioners wish to pursue
29 those points.

30 THE CHAIRMAN: Thank you, Mr. MacGregor.

glad to give if the Commissioners wish to examine

data with respect to these points that I should be

have been withdrawn, and so on. I have referred

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and this was renewed in their brief -- that the limit



1 Reading your brief I noticed that in Great Britain
2 there is very much less restriction on and control
3 of activities of insurance companies than under
4 our system. You make that point, I think at page 5,
5 and again it is mentioned at page 33. You point
6 out that our background is different. Would you
7 elaborate on that a little bit? First of all, could
8 you give us some idea as to the practices of the
9 British companies, which practices may be different
10 from ours, and to what extent their unrestricted
11 powers or less restricted powers have led them into
12 different courses than our own companies are permitted
13 to pursue? Do I make myself clear? These are British
14 companies in Britain that I am speaking of.

15 MR. MacGREGOR: Great Britain, Mr. Chairman,
16 has of course a very much longer history in the insurance
17 field than we have in Canada. Various countries
18 claim that insurance originated in their country.
19 The Italians, perhaps with respect to marine insurance,
20 and so on. But life insurance, at least on the present
21 scientific basis, may properly be said, I think,
22 to have had its origin in Great Britain. The companies
23 in Great Britain transacting business have always
24 been mainly native insurance companies, so that
25 they grew up under directors and management that
26 were pretty well known to the people being insured.

27 It is true that as years went on the
28 British companies spread almost around the globe.
29 The common impression nowadays, of course, is that
30 British insurance companies are not only very reliable

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there is very much less restriction on and control

Reading your brief I noticed that in Great Britain



1 but have always been very reliable.

2 British companies went through some pretty
3 troublous times, the same as companies in most other
4 countries. There were many failures in Britain
5 as well as elsewhere in the insurance field, but
6 primarily the answer to your question is that most
7 of the business from the start was done by native
8 companies and, if anything went wrong, it got
9 quick publicity.

10 In Great Britain, freedom and publicity
11 have been the two factors that have always been
12 emphasized in the insurance field: let the companies
13 do pretty much what they wish, let them invest as
14 they wish, let them issue the kind of contracts
15 they wish, but give them publicity as to what they
16 are doing.

17 There has been a substantial degree of
18 publicity, but in some respects there is a great
19 deal more publicity, in Canada, concerning the
20 operations of the companies. Certainly, if one
21 looks at life insurance statements put out by the
22 British companies one has more difficulty in under-
23 standing the position of such companies than one
24 has in this country, for the reason that their
25 financial statements generally reflect the life
26 insurance funds on one hand and the assets on the
27 other, but the liabilities within the fund are not
28 disclosed clearly.

29 Once every three years they have to make
30 a valuation of the life liabilities and submit that

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1 valuation in great detail to the Board of Trade,
2 but in the intervening years, if one looks at their
3 balance sheet, one sees a fund but, what surplus there
4 is in the fund in relation to the liabilities, is
5 not disclosed.

6 We in Canada, in that connection, give
7 a good deal, perhaps a great deal more, information
8 concerning the liabilities and the surplus of our
9 companies, and we give it every year.

10 Before I forget it perhaps I might mention
11 one point involving publicity here, that we in the
12 Department think is a very important point. It is
13 at least a most useful instrument in supervision
14 of companies. We give publicity to what the companies
15 do by publishing their annual statements in great
16 detail in our annual reports, and if we have any
17 particular comments to make concerning the industry
18 we endeavour to set forth those comments in the
19 introduction to our annual reports. But, apart
20 from that altogether, there is a provision in our
21 Insurance Act that authorizes the Superintendent
22 of Insurance to publish in his annual report any
23 correspondence that he may have had with a company
24 that he thinks should be made public.

25 That is a very powerful instrument and,
26 of course, is not frequently used. It has been used
27 sparingly over the years, but when it is used it
28 has a profound effect, as can well be imagined.

29 In Great Britain again, sir, they have
30 developed in different ways in many respects. In the



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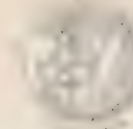
developed in different ways in many respects in the



1 life insurance field their system of distributing
2 surplus, for example, is quite different from ours.
3 In Great Britain the system traditionally followed
4 has been what they call the reversionary bonus
5 system; in other words, they distribute their
6 surplus by allotting increases to the sum insured
7 rather than granting dividends in cash.

8 On this continent the method of distribution
9 of surplus followed by, one might say, all companies
10 nowadays is to distribute surplus in cash annually
11 although the policyholder may, of course, take his
12 cash dividend in the form of additional paid-up
13 insurance if he wishes, but that is not the basic
14 or principal form of dividend. The British system of
15 distribution, of course, does not affect the cash
16 position the same, and I think it is fair to say that
17 life insurance companies, in Great Britain
18 have never been exposed to the same cash drain as
19 the companies here have been exposed.

20 Apart from the different methods of
21 distributing surplus, there has been far more
22 emphasis on this continent on cash values, automatic
23 non-forfeiture values and loan values on life
24 insurance policies. As a matter of fact, the United
25 States have gone quite far in prescribing minimum
26 cash values that must be put in insurance policies.
27 But all of these things expose the life insurance
28 companies on this continent to greater potential
29 cash demands, which the British companies in the
30 main are not exposed to. In fact, going back to earlier



life insurance field their system of distributing surplus, for example, is quite different from ours. In Great Britain the system traditionally followed has been what they call the reversionary bonus system; in other words, they distribute their surplus by allowing increases to the sum insured rather than granting dividends in cash.

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Apart from the different methods of distributing surplus, there has been far more emphasis on this continent on cash values, and on non-forfeiture values and loan values on life insurance policies. As a matter of fact, the United States have gone quite far in prescribing minimum cash values that must be put in insurance policies. But all of these things expose the life insurance companies on this continent to greater potential cash demands, which the British companies in the

also are not exposed to in fact, when back to the



1 days, if a life policyholder of a British company
2 wanted to get cash he pretty well had to bargain
3 with the company to arrange a cash settlement. These
4 things, however, have had quite an effect on investment
5 policy too in Great Britain as compared with policies
6 followed here.

7 I think it is one of the things that has
8 perhaps made equities, for example, or common stocks,
9 more attractive to British life insurance companies
10 for investments than has been the case on this
11 continent.

12 THE CHAIRMAN: Can you give us information
13 as to the the extent to which they invest in common
14 stocks in Great Britain?

15 MR. MacGREGOR: I have not the data here,
16 sir, but I would say there are many companies ---

17 THE CHAIRMAN: I just wanted a general
18 idea at the moment.

19 MR. MacGREGOR: There are several companies
20 that have more than 20 per cent of their total
21 assets in equities.

22 THE CHAIRMAN: And are those equities
23 in companies that have had a certain dividend
24 record, or do they comply with any standard of that
25 kind, as we do here?

26 MR. MacGREGOR: There are no standards
27 prescribed in the legislation.

28 THE CHAIRMAN: No, but in practice?

29 MR. MacGREGOR: In practice they are
30 good, sound companies, I would say. I know of no

days, it is a life policyholder of a British company

wanted to get cash on policy will find it difficult

with the company to arrange a cash settlement. These

things, however, have had quite an effect on investment

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THE CHAIRMAN: Now, you give us information

as to the extent to which they invest in common

MR. MCGEEHAN: I have not the data here,

air, but I would say there are many companies --

THE CHAIRMAN: I just asked a general

one at the moment.

MR. MCGEEHAN: There are several companies

that have more than 25 per cent of their total

assets in equities.

THE CHAIRMAN: And are those equities

in companies that have had a very good dividend

record, or do they come with an average of that

kind, as we know?

MR. MCGEEHAN: There is no standard?

presented in the last year.

THE CHAIRMAN: Now, let us know?

MR. MCGEEHAN: In 1930 they are



1 disposition on the part of British companies to
2 gamble or provide risk capital in any large quantities.

3 THE CHAIRMAN: What I had in mind was that
4 in view of the present state of the insurance business
5 in Canada, the experience behind it and the increase
6 of its assets and the record of its development,
7 are the regulations as necessary as they used to
8 be? Are we not at a more advanced stage of
9 maturity, that we may be similar in many respects
10 to the British companies in that connection now?

11 MR. MacGREGOR: I think it is fair to say,
12 sir, that over the years in Canada it has been the
13 general policy and practice to extend the investment
14 provisions of the insurance companies. Certainly
15 there is very much greater latitude permitted now
16 than there was in the past. I think we are steadily
17 heading towards greater and greater freedom, and
18 really I do not believe we are very far from almost
19 complete freedom.
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1 Sometime the question may be raised what
2 would companies do if there were no investment provisions
3 in our Insurance Acts. If there were none, I think
4 most companies would probably invest very much as
5 they do now, especially with the existence of the
6 present so-called basket clause, which permits
7 companies to invest 5 per cent of their assets almost
8 wholly within their own discretion.

9 We hear from time to time a good deal
10 about the small proportion of assets of Canadian
11 life companies invested in equities; however, in
12 my opinion the 15 per cent limitation has not
13 inhibited them from putting more than they have into
14 equities, but no company has yet reached the 15 per
15 cent limit in recent years.

16 Of course, history always plays a part,
17 and when we had complete freedom with respect to
18 common stock prior to 1932, some companies put quite
19 a lot --

20 THE CHAIRMAN: That is a long time ago
21 and they have learned a good deal since then.
22 The insurance companies have reached a great state
23 of maturity today as compared to that time and, as
24 I understand it, there was a request made for an increase --
25 I don't know whether it was a basket clause or some
26 other.

27 MR. MacGREGOR: They asked that the 15 per
28 cent limitation on common stocks be raised to 25 per
29 cent.

30 THE CHAIRMAN: Well, why shouldn't that be



Sometimes the question may be raised what

would companies do if there were no investment provisions

in our Insurance Act. If there were none, I think

most companies would probably invest very much as

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MR. MONTGOMERY: They asked that the 15 per

cent limitation on common stocks be raised to 15 per



1 done? They asked for it; is there any danger in
2 raising it to that extent?

3 MR. MacGREGOR: I made some comments on
4 that point, sir, in my submission.

5 It is rather interesting, looking back
6 over the years, that when we had no limitation prior
7 to 1932 the recommendation of the Department -- at
8 least, of the then Superintendent -- was that a
9 limit of 25 per cent be put in the Act. That was
10 at a time when one company had 50 per cent of its
11 assets in common stocks. It was the life companies
12 themselves that insisted that the lower limit be
13 written into the Act in 1932. The origin of the
14 present 15 per cent limit lay in the companies rather
15 than the Department.

16 THE CHAIRMAN: But we are now in 1962.

17 MR. MacGREGOR: Now the companies have
18 asked that the limit be raised to 25 per cent. Well,
19 the fact is that at the present time no company is
20 much more than half way towards the existing 15 per
21 cent limit, and for that reason, amongst others,
22 it seemed to the Department that there was no compelling
23 need to raise the limit, at least until the companies
24 showed sufficient interest to approach the present
25 limit.

26 If it had been raised, it seemed to us,
27 that it could only be interpreted as an indication
28 on the government's part that companies should invest
29 far more in common stocks than they are presently
30 doing, and many questions arise, of course, whether

done? They asked for it; is there any danger in

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at a time when one company had 50 per cent of its

assets in common stocks. It was the 150 companies

themselves that insisted that the lower limit be

written into the Act in 1932. The origin of the

present 15 per cent limit lay in the companies rather

than the Department.

THE CHAIRMAN: But we are now in 1962.

MR. MACGREGOR: Now the companies have

asked that the limit be raised to 25 per cent. Well,

the fact is that at the present time no company is

much more than half way towards the existing 15 per

cent limit, and for that reason, amongst others,

it seemed to the Department that there was no compelling

need to raise the limit, at least until the companies

showed sufficient interest to approach the present

limit. If it had been raised, it seemed to me,

that it could only be interpreted as an indication

on the Government's part that companies should invest

far more in common stocks than they are presently



1 good stocks are available for the companies to buy
2 in such quantities.

3 THE CHAIRMAN: They have asked for this
4 and they didn't get it because the Department thought
5 that they shouldn't have it because they haven't
6 used as much as they are entitled to use, and if
7 they increased it they are afraid the companies will
8 get the impression that the government was encouraging
9 it. When the insurance companies ask for a change
10 of this kind, unless there is any danger in making
11 such a change, why not let them have it?

12 MR. MacGREGOR: I think it would be wise
13 to have more experience with a larger proportion than
14 they now have in common stocks before inviting any of
15 the companies to put as much as 25 per cent of their
16 assets into common stocks.

17 The experience we have, so far as a
18 large proportion goes, involved a good many very
19 serious problems. The experience of all other companies
20 since then has involved a very small proportion of
21 common stocks, and I would feel apprehensive if any
22 venturesome company were to run up immediately to 20
23 or 25 per cent.

24 THE CHAIRMAN: It doesn't look as if any
25 of them will because they haven't used what they are
26 entitled to now, but they simply asked for broader
27 powers in case they wanted to use them.

28 MR. MacGREGOR: Sir, I think that it is
29 a better policy -- it is a matter of opinion, of
30 course -- but I do think that the government in its



1 insurance legislation, as far as investment powers
2 are concerned, has^{tended}/to broaden the powers steadily, but
3 in the light of experience -- and I think that policy
4 has worked out well -- I don't think the companies
5 have been prohibited or prevented from doing anything
6 important that they wanted to do, but it did at least
7 perhaps enable one to feel his way, so to speak, and
8 for the industry to feel its way in a more gradual
9 way.

10 That is to say, let us have progress, but
11 let us have it soundly and steadily rather than in
12 bigger bites and with the possibility of retraction.

13 Might I add that although they asked for
14 25 per cent, that request was considerably softened --
15 if not almost withdrawn -- when other amendments were
16 made permitting them to have segregated funds which
17 were not subject to any limitation as respects equities.

18 COMMISSIONER BROWN: This is in connection
19 with the pension?

20 MR. MacGREGOR: That is right, sir. At
21 the present time the highest proportion for any company
22 in common stocks is about 8 per cent; at least on
23 book values.

24 COMMISSIONER MACKINTOSH: How high has
25 any company gone in the past ten or twelve years?

26 MR. MacGREGOR: A few years
27 ago, one very small life company went slightly over
28 8 per cent.

29 THE CHAIRMAN: The life insurance companies
30 are forbidden to hold shares in or own any other life
company, and you give the reasons for that on page 78.



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in common stock is about 8 per cent, at least, and

COMMISSIONER BROWN: Now, how much
any company could in the past and in future years?
MR. MACDONALD: A few years ago,
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8 per cent. THE CHAIRMAN: The life insurance companies
are forbidden to hold more than 10 per cent of any



1 Apparently this situation arose in 1908 when you say
2 it was felt desirable to institute this state of affairs.

3 There is also mention of certain compli-
4 cations and dangers arising out of purchases of shares
5 of another life company. Could you elaborate on that?
6 What complications and dangers were there, and are
7 they still a serious thing?

8 MR. MacGREGOR: That again, sir, is a point
9 that has an interesting background. Since some of
10 the questions that are raised nowadays and suggestions
11 made, imply, I think, that ^{that} prohibition is undoubtedly
12 in the Act because of the government or the Department
13 of Insurance, and I am not sure that even the companies
14 realize that they themselves recommended that pro-
15 hibition in 1908.

16 I have here a booklet, "Amendments to the
17 New Insurance Bill Suggested by the Canadian Life
18 Insurance/Association, February 1908", where in
19 Mr. Fielding's own handwriting he accepts the
20 recommendation of the life officers that they be
21 prohibited from investing in shares of other life
22 companies. That prohibition was not in the bill
23 before the government committee at that time.

24 My personal opinion is that although much
25 can be said on either side, that on balance it is a
26 good provision. It is always difficult to know to
27 what extent one company might meddle, one might say,
28 in the affairs of another company.

29 It is not a unique prohibition; banks are
30 under the same prohibition and my understanding is that



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in the affairs of another company.
It is not a unique prohibition; similar



1 under Section 75, I think it is, a chartered bank
2 cannot invest in the shares of any other chartered
3 bank. Now, whether there would be any disposition
4 on the part of one Canadian life insurance company
5 to meddle in the affairs of another life insurance
6 company, if it were to invest in the shares of that
7 other company, I don't know.

8 Certainly there are enough other invest-
9 ments available, I think, without suggesting the
10 necessity of opening up other life companies' shares
11 as investments for such companies.

12 At the time the prohibition was put in
13 the Act in 1910, the powers of companies to invest
14 in common stocks of any kind were extremely limited,
15 and in the bill as introduced the only common stocks
16 open to Canadian life insurance companies would have
17 been bank stocks. The life companies wanted something
18 broader than that, and they suggested provisions
19 relating to other kinds of corporate stocks with
20 dividend records, and so on, but coupled with that
21 they recommended this prohibition against investment
22 in other life stocks. I see no point in permitting
23 it under present conditions unless the object were
24 to purchase enough shares of the other life company
25 to control it.

26 THE CHAIRMAN: Is there any objection to
27 that?

28 MR. MacGREGOR: Well, of course, the
29 suggestion has been made in recent years that the
30 prohibition should be removed, that it is an anomaly



Page 10

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it under present conditions unless the object were
to purchase enough shares of the other life companies
to control it.

THE CHAIRMAN: Is there any objection to

MR. MACGREGOR: Well, of course, the

suggestion has been made in recent years that the



1 that British and foreign life insurance companies may
2 come into Canada and buy control of a Canadian life
3 insurance company, while our own Canadian life insurance
4 companies ostensibly have to stand by and can do
5 nothing.

6 If the prohibition were removed so that
7 a Canadian life insurance company could purchase
8 control of another Canadian life insurance company,
9 there would be no point in the purchasing company
10 continuing to operate the other Canadian life insurance
11 company so purchased in Canada; in the interests of
12 efficiency and certainly under present conditions
13 the obvious thing to do would be to merge the two
14 companies and operate them as one.

15 Briefly, the only point in one Canadian
16 life insurance company buying another company, a
17 life insurance company, would be to grow much more
18 quickly and that, of course, raises a further question;
19 whether it is desirable that the number of Canadian
20 life insurance companies should diminish.

21 When it comes to competing on the purchase
22 of a Canadian life insurance company, I think in
23 most cases the British or foreign interests that
24 may be looking for some Canadian life company to
25 buy would probably out-bid another Canadian life
26 company because in most cases the British or foreign
27 life company from outside -- or other interests, or
28 who ever they are -- in purchasing the Canadian life
29 company must have in mind doing life business in
30 Canada, and they must have in mind purchasing an



1 existing organization, something they haven't got,
2 and usually it is an agency organization that they want,
3 which is so difficult to build up in Canada.

4 Another Canadian life insurance company
5 has not the same need of a second agency organization.
6 It is true they could undoubtedly acquire some good
7 men both in the head office and in the branch office
8 and in the agency field, but coupled with the acquisition
9 of some good men, they/have also quite a problem in
10 trying to integrate all the rest of the staff and
11 the officers and agents and so on, with their own.

12 In general, I think in most cases, British
13 and foreign interests could and would pay a higher
14 price than other Canadian life companies would pay.
15 It might almost involve, in some cases, a Canadian
16 life company paying more than another Canadian life
17 company is worth to get it in order to grow big more
18 quickly.

19 We see something of the same sort of thing
20 in the agency field. It is a terribly difficult
21 problem to build up a good agency organization in
22 Canada. Why should a good life insurance agent
23 leave a good company to go with another company
24 unless he is going to be paid more or get more in
25 some fashion than the good company he is with is now
26 paying him. It pretty much amounts to a situation
27 where the smaller company or the newer company, wanting
28 to acquire a good agent, has to pay him almost more
29 than he is worth in order to get him away from the
30 company with which he is presently well established.

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1 COMMISSIONER LEMAN: In the case of a mutual
2 life company, how does one go about buying such a company?

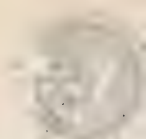
3 MR. MacGREGOR: I don't think it is possible
4 to buy one, sir. There is nothing to buy in the
5 sense that there is no stock to buy; the policy-
6 holders control the company.

7 COMMISSIONER LEMAN: Is it possible to make
8 some kind of an offer to the participating policy-
9 holders that would enable you ---

10 MR. MacGREGOR: No sir, because they have
11 no interest beyond their own policies and they have
12 no rights or powers beyond their own policies individually.

13 COMMISSIONER LEMAN: So, to the extent
14 that a life insurance company is mutualized, there
15 is some insulation against what you are now describing
16 as far as they are concerned?

17 MR. MacGREGOR: So far as control is
18 concerned, they are beyond purchase. So that to get
19 back to the question I was discussing a moment ago,
20 if this prohibition were removed, among other things
21 I think it would inevitably result in a shrinkage
22 in the number of Canadian life insurance companies;
23 if other Canadian life companies were to buy their
24 brethren. There again it is a matter of opinion
25 whether we should have fewer life companies than we
26 have. Right or wrong, certainly the policy of the
27 Dominion government over a long period has been based
28 on the view that we haven't too many Canadian life
29 insurance companies in the field.
30



COMMISSIONER LEWIS: In the case of a mutual

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COMMISSIONER LEWIS: So, to the extent

that a life insurance company is not fixed, where

is some insulation against what you are now describing

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on the view that we haven't too many Canadian life

insurance companies in the field.



1 Knowing the terrible problems and waste, too, involved
2 in starting new companies, it seems better to keep the
3 companies that are in existence on the scene than
4 to see the number shrink, especially if it would
5 be followed then by a mushrooming. One might say,
6 "Well, if Parliament, in its wisdom, thinks that
7 it would be better if we had a smaller number of
8 companies, why then, let the numbers shrink" --
9 and then Parliament in its wisdom, would refuse to
10 incorporate new ones, except perhaps under exceptional
11 circumstances, if the number could be controlled
12 in that manner. But the problem could not be
13 controlled in that manner because if people wanted
14 to start a new company and Parliament refused, they
15 would then go to a provincial legislature and
16 get incorporated there. My own view, right or wrong,
17 is that if the number of life companies in Canada
18 were to shrink substantially, I think we would be
19 faced with the attempted incorporation of a pretty
20 large number of new companies.

21 COMMISSIONER MacKEEN: Mr. MacGregor,
22 if the Canadian companies would not pay as much
23 as the foreign companies can now pay, there would
24 not be as much chance of a Canadian company taking
25 over another company.

26 MR. MacGREGOR: The Canadian company would
27 have to pay more than the British or foreign company
28 is prepared to pay. The idea of mergers can spread;
29 I think it might almost become the fashion. I
30 cannot speak for the companies, but certainly in



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I think it right almost because of the fact that I



1 my experience, where the odd merger takes place it
2 stimulates a desire on the part of other companies
3 to buy up companies, to grow large more quickly.

4 We have seen something of that kind in
5 the trust field in Canada. One company does not
6 like to see its competitor buy up another company
7 and increase its size very substantially. It gives

8 that company the idea to do the same thing.
9 Sometimes it is in the interests, and in most
10 cases it is undoubtedly in the interests of all
11 concerned that a merger be permitted, or I shouldn't
12 expect the governments having authority in the matter
13 would acquiesce or approve of such mergers. But
14 I think that in some cases some pretty high prices
15 have been paid for other companies taken over,
16 and I think in some cases the purchase has not been
17 quite the bargain it appeared to be at the outset.

18 COMMISSIONER MacKEEN: If the number of
19 companies were reduced by a certain number, do you
20 think that would have any appreciable effect on
21 the selling cost of insurance -- in other words,
22 cutting down on overhead and sales expenses?

23 MR. MacGREGOR: It would more likely add
24 to the cost, in the sense that it costs a lot of
25 money to get a new life company started, and it
26 takes a very long time. I would expect that if the
27 number of companies were to be reduced through a
28 lot of mergers we would have a lot of new companies
29 starting up; and I think, on balance, it would
30 add to the cost. There is no doubt that the business



my experience, where the old merger takes place it stimulates a desire on the part of other companies to buy up companies, to grow large more quickly. We have seen something of that kind in the trust field in Canada. One company does not like to see its competitor buy up another company and increase its size very substantially. It gives that company the idea to do the same thing. Sometimes it is in the interests, and in most cases it is undoubtedly in the interests of all concerned that a merger be permitted, or I should expect the governments having authority in the matter would acquiesce or approve of such mergers. But I think that in some cases some pretty high prices have been paid for other companies taken over, and I think in some cases the purchase has not been quite the bargain it appeared to be at the outset. COMMISSIONER MCKINLEY: If the number of companies were reduced by a certain number, do you think that would have any appreciable effect on the selling cost of insurance -- in other words, cutting down on overhead and sales expenses?

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1 can be carried on more efficiently by a reasonable
2 number of substantial companies as compared to a
3 larger number of smaller companies. The costs today,
4 over-all, I would say, are better from the policyholders'
5 point of view than they were even 25 years ago. I
6 think we are going to see increasing competition
7 in the life field and greater pressure on the
8 smaller companies.

9 I think the fact that some of our largest
10 companies have mutualized or are mutualizing is one
11 factor. It means the policyholders are entitled
12 to all the profits, and they consequently are in a
13 position to offer insurance at cost. Certainly,
14 there is no shareholder interest involved at all,
15 but there are other factors that I think are going
16 to tend to increase the competitive pressure.

17 The largest life insurance company in
18 the world that does a very substantial life insurance
19 business in Canada has, until very recently, been
20 under certain restrictions in its home state that
21 even affected its operations in Canada. For example,
22 the laws of its home state prohibited the company,
23 being a mutual company, from charging different
24 premium rates in Canada as compared to the United
25 States, even though it may be earning more
26 on its investments up here. That restriction was
27 removed about two years ago. The company also
28 operated under a somewhat similar restriction as
29 respects dividends to its policyholders. The attitude
30 of its home state within the last year has changed



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1 in that respect too, so that that very large mutual
2 life company may now, in effect, have closer regard
3 for its actual experience in operating costs in
4 Canada, and I think that means it can offer insurance
5 on better terms to Canadians than it has been able
6 to do in the past.

7 There are several things of this kind
8 that are tending, I think, to increase competitive
9 pressures in the life field; and, certainly, the
10 same exists, by reason of the number of companies,
11 in the fire and casualty insurance field. Everything
12 seems to point to more competition rather than less.

13 COMMISSIONER BROWN: If there are certain
14 economies in size, is it better, in your opinion,
15 to let some of our Canadian companies amalgamate
16 and obtain this economy of size, rather than letting
17 them be swallowed up by foreign purchasing? This
18 is also involved in the other side of it, and that
19 is: Is there more danger of smaller companies
20 being taken over by foreign companies than larger
21 companies?

22 MR. MacGREGOR: In general, I think it
23 is correct to say, "Yes": Most foreign companies
24 wanting to do business in Canada cannot afford
25 to pay too much to buy a company, and most of them
26 probably are not anxious to start into business in
27 Canada in too large a way, so that up to date most
28 of the Canadian life companies that have been purchased
29 by non-Canadian interests have been small. They
30 have all been small, with one exception, and it was



1 a medium-sized company.

2 Most of our Canadian life companies are
3 pretty old, and the fact that some of them are
4 still relatively small, even though old, perhaps
5 suggests that their agency organization at least
6 has not been as good as most other companies.

7 So that if non-Canadian interests have purchased
8 that kind of company, maybe they have not got all
9 that they were looking for.

10 COMMISSIONER BROWN: Surely, you are not
11 suggesting we do this so as to persuade the foreigner
12 to buy a poor bargain?

13 MR. MacGREGOR: No. I should not give
14 the impression that the larger Canadian life companies
15 have been immune or have not been exposed to risk
16 of acquisition by foreign interests; they most
17 certainly have.

18 COMMISSIONER BROWN: What I was trying
19 to get at was that the exposure was probably less
20 if they are larger as against smaller companies.

21 MR. MacGREGOR: No, I should not like to
22 leave it that way, sir.

23 In the last ten years some of our very
24 largest Canadian life companies were very seriously
25 exposed to the risk of acquisition by foreign
26 interests, and it was that fact that gave rise
27 to mutualization in most cases. It was one way
28 of keeping control in Canada.

29 COMMISSIONER BROWN: There is one other
30 question on the same lines, and that is: if the

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question on the same lines, and that has to do



1 smaller companies are less economic in their operation,
2 on the basis of a higher cost ratio for a lot of
3 things, is this extra cost, which means uneconomic
4 operations in the capital market in Canada, really
5 justified?

6 MR. MacGREGOR: I do not think the
7 differences in cost are that great, sir. Again,
8 I should not like to leave the impression that all
9 small companies operate less efficiently than larger
10 companies. It is true that large companies can
11 use mechanical equipment, and so on, that tends to
12 cut down their costs relatively; but the smaller
13 companies, in many cases, have had a very successful
14 investment experience, for example. That tends
15 to offset expenses on the other side. There is not
16 that great disparity between the net costs of
17 insurance in one company as compared to another.

18 The greatest relative cost is likely to arise
19 among young companies; but even though we have
20 still several relatively small Canadian life companies
21 they are relatively old. It is the young company
22 where expenses are relatively high.

23 It is that sort of thing I think it is
24 wise to avoid, if we can; that is, the mushrooming
25 of a lot of new companies.

26 COMMISSIONER BROWN: This leads, naturally,
27 to the further question. You have twice expressed
28 the opinion that if further amalgamations were
29 permitted there would be a flood of new applications
30 for incorporation and operation. Why do you think

smaller companies are less economic in their operation,

on the basis of a higher cost ratio for a lot of things, is this extra cost, which means uneconomic operations in the capital market in Canada, really

MR. MACGREGOR: I do not think the

differences in cost are that great, sir. Again,

I should not like to leave the impression that all

small companies operate less efficiently than larger

companies. It is true that large companies can

use mechanical equipment, and so on, that tends to

cut down their costs relatively; but the smaller

companies, in many cases, have had a very successful

investment experience, for example. That tends

to offset expenses on the other side. There is not

that great disparity between the net costs of

business in one company as compared to another.

The greatest relative cost is likely to arise

among young companies; but even though we have

still several relatively small Canadian life companies

they are relatively old. It is the young company

where expenses are relatively high

It is that sort of thing I think it is

wise to avoid, if we can; that is, the mushrooming

of a lot of new companies.

to the further question. You have twice expenses

the opinion that if further amalgamations were

permitted there would be a flood of new applications

for incorporation and operation. Why do you think



1 this would come about?

2 MR. MacGREGOR: Well, I think that mergers,
3 perhaps, on the surface indicate success in many
4 instances. Where companies grow, merge and, apparently,
5 are successful, I think it attracts the attention
6 and desire on the part of many persons to get into
7 that business and start a company and do the same
8 thing.

9 In a sense I think we are witnessing
10 a little of that sort of thing in the trust field
11 at the present time. Really, since the war the
12 experience of the smaller trust companies, in the
13 main -- and there are exceptions, of course -- is
14 that they have had a difficult time in many cases
15 "buttering their bread," so to speak. The trend,
16 therefore, was for the smaller trust companies to
17 sell out to the larger trust companies; and, of
18 course, in many cases the larger trust companies
19 have found it more and more necessary to have a
20 nation-wide organization in order to service its
21 own clients,

22 There were some very good little trust
23 companies in certain localities that were well-
24 imbedded, so to speak, and not in any difficulty
25 whatsoever; but the larger trust companies thought
26 it best to buy out that small company rather than
27 to compete with it in that locality.

28 However, the smaller trust companies have,
29 I think, felt increasingly the competition of the
30 larger ones, and the trend has been for them to



...this would come about?

MR. MCGRAW: Well, I think that mergers

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larger ones, and were forced to sell out to them.



1 disappear. On the other hand, I think we are
2 witnessing now a desire on the part of a good many
3 persons to start up new trust companies. There has
4 been more interest evidenced in that respect in
5 the last three or four years than, certainly, there
6 was in the preceding 15 to 20 years. I think that
7 people, when they see success, would like to get
8 into that business.

9 COMMISSIONER MACKINTOSH: Is there anything
10 to prevent a Canadian company buying the assets
11 and liabilities of another Canadian company?

12 MR. MacGREGOR: Nothing whatsoever, sir.
13 There has been a provision in the Act, for many,
14 many years, permitting a Canadian life company or
15 a Canadian fire and casualty company to buy the
16 assets and business of another company, by agreement.
17 But I must say that, there again, the policy of
18 the government and the Treasury Board has been
19 against unnecessary purchases or mergers of that
20 kind, unless in the interests of the policyholders,
21 because the result would be a shrinkage in the
22 number of companies. That has been so in the life
23 field, but it has been less so in the fire and
24 casualty field.

25 There is one point that should be mentioned,
26 as far as control and acquisition of companies is
27 concerned. If a Canadian company were to buy
28 another Canadian company the obvious and sensible
29 thing to do would be to merge, and the purchased
30 company would disappear. Where British or foreign



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1 interests buy control over a Canadian company,
2 the Canadian company, of course, continues as such;
3 its identity is preserved, and there is no reduction
4 in the number.

5 COMMISSIONER BROWN: The prohibition is
6 against investing the life insurance funds in the
7 shares of another company. Has this prohibition
8 operated also to prevent mergers, in the sense of
9 share exchanges, where instead of the companies
10 being the "X" company and the "Y" company, they
11 become the "X and Y" company?

12 MR. MacGREGOR: I do not think so, sir.

13 COMMISSIONER BROWN: In other words, mergers
14 could have taken place?

15 MR. MacGREGOR: They could not have, I
16 should say, without special legislation. For one
17 thing, in the life field at least, the capital
18 stock of each life company is strictly limited in
19 its act of incorporation, and usually it has been
20 \$1 million, but in a few cases more. In most
21 cases the stock has been fully issued and subscribed
22 and paid, so the companies have had no treasury
23 stock that could have been used for a merger of
24 the kind you have mentioned. But the art has not been
25 a barrier, because if that were to take place the
26 two companies would merge, and there would be one
27 resulting company; and if that is desired it can also
28 be accomplished by purchase and sale, by
29 agreement covering the purchase and sale of the
30 assets and business.



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MR. BRIDGES: I do not think so, sir.

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1 COMMISSIONER BROWN: My point was, that
2 this would not involve investing the life insurance
3 funds.

4 MR. MacGREGOR: I see. There has been
5 no expressed desire to carry out anything of that
6 kind. First of all, the companies have not had
7 extra treasury stock to effect it. A transaction
8 of that kind would be governed in the same way by
9 the Treasury Board and its policy, and I think the
10 attitude of the Board -- I cannot speak for it --
11 would probably be the same as in respect of an
12 agreement to purchase the assets and liabilities,
13 because it would mean the disappearance of one company,
14 or at least it would result in one company instead
15 of two.

16 I am reminded of one point that I
17 mentioned in my submission, that perhaps should
18 also be mentioned again. I think there is an
19 increasing interest on the part of most persons in
20 the particular company in which they are insured.
21 I think in the older days when the amount of the
22 personal budget that went for insurance was pretty
23 small, people in the main paid less attention to the
24 company in which they were insured. Certainly in
25 the fire and casualty field I think it is fair
26 to say that a great many people -- perhaps most
27 people -- scarcely knew their agent, much less the
28 insurance company in which they were insured.

29 In the life field I think there has always
30 been a greater degree of circumspection, but I think



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In the life field I think there has always

been a greater degree of conservatism, but I think



1 in both fields there is an increasing degree of cir-
2 cumspection. The part of one's personal budget that
3 goes for insurance now is substantially larger, with
4 automobile coverage, more comprehensive coverage on
5 one's dwelling, and a far greater interest in life
6 insurance, pensions, annuities, and so on. I think
7 that where people do exercise some judgment in choosing
8 their life company -- and I think most of them
9 exercise quite a bit of judgment since it is a long
10 term contract -- but having chosen it, it seems to me
11 wrong that they should then be shunted around, so
12 to speak, in the mergers of companies, and so on,
13 with different managements, different investment
14 policies, different in many respects, and there is
15 nothing the policy owner can do about it.

16 Having taken out his contract, usually
17 he can only surrender it to his disadvantage. With
18 a fire and casualty contract, of course, it is a
19 short term contract rather like one's boarding house;
20 if he does not like it after a year when the
21 policy expires, he can go to another company, if he
22 does not like the treatment afforded by that company
23 in the settlement of claims, or whatever it is.
24 But where he has taken out his life insurance with
25 a particular company, it seems wrong in principle
26 that these policyholders should be bandied around
27 in mergers.

28 THE CHAIRMAN: On the other hand, the
29 personnel of the company changes during the lifetime
30 of the policyholder, and that might change the sort



in both fields there is an increasing degree of competition. The part of one's personal budget that goes for insurance now is substantially larger, with automobile coverage, more comprehensive coverage on one's dwelling, and a far greater interest in life insurance, pensions, annuities, and so on. I think that where people do exercise some judgment in choosing their life company -- and I think most of them exercise quite a bit of judgment since it is a long term contract -- but having chosen it, it seems to me wrong that they should then be shunted around, as to speak, in the mergers of companies, and so on, with the result that the policyholder is shunted around in many respects, and there is nothing the policy owner can do about it.

Having taken out his contract, usually he can only surrender it to his disadvantage. With a fire and casualty contract, of course, it is a short term contract rather like one's boarding house; if he does not like it after a year when the policy expires, he can go to another company, if he does not like the treatment afforded by that company in the settlement of claims, or whatever it is. But where he has taken out his life insurance with a particular company, it seems wrong in principle that these policyholders should be shunted around in mergers.

THE CHAIRMAN: On the other hand, the

personnel of the company changes during the lifetime of the policyholder, and that makes changes the sort



1 of treatment he would get. How do you prevent that
2 from happening?

3 MR. MacGREGOR: One cannot, sir. At the
4 same time, I can throw a little light on that, I think.
5 It is very striking, really, the effect that the
6 top officers of a company have on the whole organization
7 under them; the whole corporate personality, so to
8 speak. Certainly that is so in many cases, if not
9 in most cases. We, as examiners, going into all
10 kinds of companies, cannot help noticing the different
11 atmosphere in some companies as compared with others.

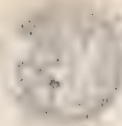
12 I think in most cases that atmosphere
13 grows over the years and is not something that changes
14 rapidly, even though the top officers ---

15 THE CHAIRMAN: But you think a merger
16 might result in a change?

17 MR. MacGREGOR: I certainly do. I think
18 mergers are often upsetting all the way down the
19 line; to officers, agents --

20 THE CHAIRMAN: On the other hand, if the
21 merger strengthens the position of the company and
22 provides a better deal for a policyholder, why
23 should there be any objection? Why would companies
24 merge unless they thought there was some advantage
25 in doing it?

26 MR. MacGREGOR: There are many reasons, sir.
27 I do not want to be unfair to the companies, but
28 companies like to grow. They are very conscious
29 of their size, in relation to competitors, and their
30 progress relative to the progress of their competitors.



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1 One cannot help coming to that conclusion, in seeing
2 the figures of business in force, and all the rest
3 of it, that are published every year. There is always
4 great emphasis on their size, rate of growth, and so
5 on.

6 Companies like to grow, and grow big; and
7 grow big as quickly as they can, in some cases. Mergers
8 are undoubtedly influenced, if not induced, mainly
9 through desires to economize and operate more
10 efficiently; but one cannot overlook that other aspect
11 of growth for its own sake. I do not think there is
12 sufficient evidence that if two companies were to
13 merge they could, of necessity, operate more economically.
14 In some cases I think there might be a tendency to
15 retain personnel, to double personnel, so to speak.
16 You cannot eliminate a lot of officers and a lot of
17 staff in a merger; you have to keep most of them on,
18 for some period anyway, even though in the long run
19 the combined company may operate more efficiently.

20 COMMISSIONER BROWN: I have just one
21 question I should like to ask you about the foreign
22 operations. You mention the arguments against the
23 companies operating with foreign subsidiaries,
24 and so forth. Has this factor of operating as one
25 complete company given rise to any double liabilities,
26 in the sense of where political complications arise
27 and people have to get out of a country, and the
28 company has a liability to the individual, and then
29 the government of the country insists on a liability
30 to the government of the country as well?



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COMMISSIONER BROWN: I have just one question I should like to ask you about the foreign operations. You mention the arguments against the companies operating with foreign subsidiaries, and so forth. Has this factor of operating as one complete company given rise to any double liability, in the sense of where political complications arise and people have to get out of a country, and the company has a liability to the individual, and then the Government of the country insists on a liability



1 MR. MacGREGOR: That has not been a problem
2 in the past, sir, although there are some problems
3 on hand now of that kind. Where a company issues
4 a policy to a resident of a foreign country, certainly
5 the company as a whole is liable for that policy.
6 It may be that the country where that policyholder
7 resides has taken precautions in the way of requiring
8 certain assets to be deposited locally for the protection
9 of its policyholders there. But in the past, where
10 difficulties have arisen in foreign countries -- and
11 there have been many cases of it -- whether through
12 nationalization or nationalistic policies of one
13 kind or another that have developed in those foreign
14 areas, in every case the policyholders have retained
15 their equity but the companies have not had to pay
16 twice, so to speak.

17 There have been some peculiar situations in
18 some cases. Our life companies operating in foreign
19 fields seldom had an excess of assets over liabilities
20 in the foreign country but occasionally they had. In
21 Japan, for example, there were two Canadian life
22 companies just before the war. The asset position
23 of one was a little long, and the asset position
24 of the other was a little short, and when Japan took
25 over the business, the company with assets that were
26 a little long sought to get the excess released and
27 Japan said, "No, we will not give you anything. You
28 ask the other company that is a little short". I
29 think there was an adjustment between those companies
30 in that case.



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1 But the point you raise, sir, is a very
2 important one and a very significant one at the present
3 time, because in the past, where a Canadian company,
4 usually a life company, was forced out of a foreign
5 field, the policyholders in that foreign field remained
6 in that field, in their own country. There was no
7 problem involving the mass migration of policyholders;
8 and that is a problem at the present time; and it is
9 a problem in Cuba at the present time. There is a
10 possibility that the same sort of problem might
11 arise in other areas of the world -- in Africa, for
12 example.

13 It has occurred in a small way in Egypt,
14 where a considerable number of policyholders
15 left Egypt, and when Egypt took over the business in
16 Egypt of our Canadian companies, a satisfactory
17 solution was found there by negotiation with the
18 Egyptian authorities. In other words, the Egyptian
19 authorities agreed to release certain assets that
20 might be related to the Egyptians who had left Egypt.
21 But the problem is more serious at the present time
22 in reference to a country like Cuba, where a lot of
23 Cuban policyholders have fled to the U.S.A. and naturally
24 look to the companies to deal with them, quite apart
25 from the fact that they took their policies in Cuba,
26 and yet the policies are governed by Cuban laws; they
27 were taken in Cuba, they were issued in Havana and
28 the companies have assets in Cuba, to the extent of
29 their liabilities in the main. That is an unresolved
30 problem.



But the point you raise, sir, is a very important one and a very significant one at the present time, because in the past, where a Canadian company, usually a life company, was forced out of a foreign field, the policyholders in that foreign field remained in that field, in their own country. There was no problem involving the mass migration of policyholders; and that is a problem at the present time, and it is a problem in Cuba at the present time. There is a possibility that the same sort of problem might arise in other areas of the world -- in Africa, for instance. It has occurred in a small way in Egypt, where a considerable number of policyholders left Egypt, and when Egypt took over the business in Egypt of our Canadian companies, a satisfactory solution was found there by negotiation with the Egyptian authorities. In other words, the Egyptian authorities agreed to release certain assets that might be related to the Egyptians who had left Egypt. But the problem is more serious at the present time in reference to a country like Cuba, where a lot of Cuban policyholders have fled to the U.S.A. and naturally look to the companies to deal with them, quite apart from the fact that they took their policies in Cuba, and yet the policies are governed by Cuban laws; they were taken in Cuba, they were issued in Havana, and the companies have assets in Cuba, to the extent of their liabilities in the main. That is an unsolved



1 COMMISSIONER LEMAN: Is not the existence of
2 this unresolved problem an argument in favour of letting
3 these companies operate through a subsidiary in those
4 foreign countries?

5 MR. MacGREGOR: I think, not, sir. I can
6 really see very few advantages in a Canadian life
7 company operating through a subsidiary in a foreign
8 country. On the basis of experience, they have
9 up to date operated on a branch office system, and
10 very successfully, the world over. Where they have
11 been forced out of different countries, it was not
12 because of the method by which they were operating.
13 I do not think it would have made any difference.

14 For example, in Egypt it would not have
15 made any difference if a Canadian life company had
16 been operating there through an Egyptian subsidiary;
17 it would have been taken over. The same in India.
18 I think the greatest appeal that our Canadian life
19 companies have had in these foreign fields is the
20 strength and stability of the company itself,
21 and I think a lot of that appeal would have been
22 dissipated if they had attempted to operate through
23 a local subsidiary.

24 Many policyholders in these foreign lands
25 want a policy in dollars, and they want it with a
26 company outside their native land. I do not think
27 that desire is satisfied by a policy in a native
28 subsidiary. I think in practically all cases where
29 our companies have been forced out of foreign fields,
30 financially they would have fared worse if they had had



COMMISSIONER BEMAN: Is not the existence of

this unresolved problem an argument in favor of letting
these companies operate through a subsidiary in some
foreign country?

MR. HANCOCK: I think not, sir. I can

hardly see very few advantages in a Canadian or
company operating through a subsidiary in a foreign
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up to date operated on a branch office system and
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our companies have been forced out of foreign fields,
they would have been able to operate if they had



1 a subsidiary there, because, as I mentioned a moment
2 ago, in most cases our companies have not had an
3 excess of assets over liabilities in those foreign
4 lands; they have either been pretty well in balance
5 or have been short in assets. But if you have a
6 native subsidiary you are bound to have an excess of
7 assets there, at least to the extent of your capital
8 and surplus, and I think our companies, financially,
9 would have been worse off. I do not see under
10 what circumstances they could have been better off
11 had they operated through a subsidiary.

12 The case for subsidiaries nowadays in the
13 insurance field seems to be strongest where you are
14 practically certain that economic and political
15 conditions in that country are safe and sure for
16 as long as you can see ahead. But if there is any
17 risk or doubt whatsoever, I think the branch office
18 basis is the better basis from the company's point
19 of view.

20 I would hate to think that our Canadian
21 life companies had subsidiaries in Cuba at the present
22 time. At least, I think their problems would be
23 worse than they are now.

24 COMMISSIONER BROWN: The only difference,
25 I suppose, would be that the liability to the policy-
26 holder would be more direct to the subsidiary rather
27 than to the whole company?

28 MR. MacGREGOR: It would be more direct,
29 but I am quite satisfied that they would never have
30 sold the quantity of business that they did. Perhaps



and, in most cases our companies have not had an excess of assets over liabilities in those foreign lands; they have either been pretty well in balance or have been short in assets. But if you have a native subsidiary you are bound to have an excess of assets there, at least to the extent of your capital and surplus, and I think our companies, respectively, would have been worse off. I do not see under what circumstances they could have been better off had they operated through a subsidiary.

The case for subsidiaries nowadays in the insurance field seems to be strongest where you are practically certain that economic and political conditions in that country are safe and sure for as long as you can see ahead. But if there is any risk or doubt whatsoever, I think the branch office bears the brunt of the danger from the company's point of view.

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COMMISSIONER BROWN: The only difference, I suppose, would be that the liability to the policyholder would be more direct to the subsidiary rather than to the whole company.

But I am quite satisfied that they would never have



1 that would be a good thing, under existing conditions.

2 I do believe that a great many Cubans
3 took policies in our Canadian companies because they
4 wanted dollar policies in a Canadian company; they
5 did not want a contract in pesos in a Cuban company.

6 COMMISSIONER BROWN: The suggestion is
7 that the companies knew themselves that they had
8 this double liability possibility.

9 MR. MacGREGOR: The only risk of double
10 liability is in respect of a Cuban policyholder who
11 leaves Cuba and in some fashion seeks to obtain from
12 the company payment of his policy even though the
13 Cuban government has confiscated his policy as part
14 of his property, and the Cuban government says to the
15 Canadian life companies, "Pay me", the government.
16 That has not yet arisen.

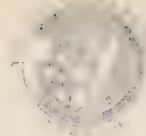
17 COMMISSIONER BROWN: You say no cases of
18 that have arisen?

19 THE CHAIRMAN: Not yet.

20 MR. MacGREGOR: There have been several
21 court cases in the U.S.A. where Cuban policyholders
22 who have fled Cuba have taken action against the
23 Canadian companies to surrender their policy, even
24 though legally it seems clear that it is a Cuban
25 policy and can only be paid in pesos in Havana.

26 COMMISSIONER LEMAN: I thought you were
27 talking about dollar policies.

28 MR. MacGREGOR: Well, the situation is
29 quite complicated, Mr. Leman. It is true that the
30 policies prior to 1951, at least, were issued in



that would be a good thing, under existing conditions.

I do believe that a great many Canadians

took policies in our Canadian companies because they

wanted dollar policies in a Canadian company; they

did not want a contract in respect to a Canadian company.

COMMISSIONER BROWN: The suggestion is

that the companies knew themselves that they had

this double liability possibility.

MR. MACDONALD: The only right of double

liability is in respect of a Canadian policyholder who

leaves Cuba and in some fashion seeks to obtain from

the company payment of his policy even though the

Cuban government has confiscated his policy as part

of his property, and the Cuban government says to the

Canadian life company, "Pay me", the government.

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COMMISSIONER BROWN: You say no cases of

that have arisen?

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who have fled Cuba have taken action against the

Canadian companies to surrender their policy, even

though legally it seems clear that it is a Cuban

policy and can only be paid in pesos in Havana.

COMMISSIONER BROWN: I thought you were

talking about dollar policies.

MR. MACDONALD: Well, the situation is

quite complicated. Mr. Brown, it is true that the



1 dollars, but by a decree of the Cuban government in
2 that year all contracts, even though written in dollars,
3 were changed to pesos, so that since then the currency
4 of the policies has been pesos, whether originally
5 written that way or not. But, likewise, since those
6 difficulties and rules have developed, most of the
7 Canadian life companies have tended to cut down on
8 their new business there; not in every case, but in
9 most cases.

10 COMMISSIONER LEMAN: I thought the way Mr.
11 Brown was referring to a form of double liability was
12 this, that you lose your assets and still owe on the
13 policies. Suppose one of these Cuban refugees died;
14 would the Canadian company refuse to pay on that policy?

15 MR. MacGREGOR: They would never refuse.
16 Legally they believe their position is that they would
17 pay in pesos in Havana. But these policyholders who
18 have fled have, in some cases, taken action in Florida
19 courts against the Canadian company, seeking payment in
20 dollars in the U.S.A.

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dollars, but by a decree of the Cuban Government in that year all contracts, even though written in dollars, were changed to pesos, so that since then the currency of the policies has been pesos, whether originally written that way or not. But likewise, since those difficulties and rules have developed, most of the Canadian life companies have failed to cut down on their new business there; not in every case, but in most cases.

COMMISSIONER MANN: I thought the way Mr. Brown was referring to a form of double liability was that, that you lose your assets and still owe on the policies. Suppose one of these Cuban companies died; would the Canadian company refuse to pay on that policy. Mr. Macdonald: They would never refuse.

legally they believe their position is that they would pay in pesos in Havana. But these policyholders who have filed here, in some cases, taken action in Florida, course against the Canadian company, noting payment in dollars in the U.S.A.



1 MR. MacGREGOR: There have been a few
2 cases that have gone against the companies. Those
3 cases are being appealed and really it remains
4 to be seen yet what the ultimate legal situation
5 will be.

6 THE CHAIRMAN: We will now adjourn for
7 15 minutes.

8
9 --- Recess

10 THE CHAIRMAN: We will now resume.

11 COMMISSIONER GIBSON: I should like to
12 ask Mr. MacGregor a few questions in the area of
13 investments and limitations on investments. YOu
14 have already answered a number of these questions
15 in part in answer to some of the Chairman's questions,
16 but I should like to explore some other aspects
17 of this with you.

18 I think that you appreciate that our
19 interest in this is from the point of view of the
20 flow of funds, and naturally we are particularly
21 interested in any impediment to the free flow
22 of funds to satisfy ourselves that the reasons for
23 these impediments are sensible.

24 You do say that, speaking of the various
25 investment limitations in general, the Acts do not
26 seriously hamper companies in any of these respects.
27 You have expressed your general view on this and
28 pointed out in regard to the limitation on the
29 purchase of common stocks that no one of the companies
30 is close to the 15 per cent.



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COMMISSIONER CLEGG: I should like to

ask Mr. MacGregor a few questions in the area of

investments and limitations on investments. You

have already answered a number of these questions

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these impediments are sensible.

You do say that, speaking of the various

investment limitations in general, the laws do not

seriously hamper companies in any of these respects.

You have expressed your general view on this and

pointed out in regard to the limitation on the

purchase of common stocks that no one of the companies

is close to the 10 per cent.



1 What I was wondering was, does the
2 fact that there are a lot, or quite a few investment
3 limitations possibly create an environment ^{against} / changing
4 investment policy on the part of companies?
5 Do you think they are less likely to think of re-arranging
6 or changing their investment habits because there
7 are these limitations?

8 MR. MacGREGOR: I think there might have
9 been a greater disposition along those lines had it
10 not been for the enactment of the so-called "Basket
11 Clause" of 1948. That clause for the first time
12 really gave companies freedom to invest as they
13 like. At that time the limitation was 3 per cent
14 of their assets. That was raised to 5 per cent in
15 the amendments of 1961.

16 I think that clause has been a good one
17 and I think it met in part at least, if not to a
18 substantial degree, the point you have in mind,
19 as I understand it. It is true that if companies
20 are faced with a long series of "dos and don'ts"
21 with no latitude, I suppose it might induce
22 in some the kind of thinking that they have no
23 freedom at all and they just do what they are told.
24 I think the fact is that companies of their ^{own} / volition
25 would probably put 90 to 95 per cent of their
26 assets in those kinds that are prescribed, or that
27 they do invest in now.

28 With the existence of the 5 per cent
29 margin where they may buy any bond or stock they like
30 as long as the bond or debenture is not in default,



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Do you think they are less likely to think of re-structuring

or changing their investment habits because there

are these limitations?

MR. MACDONALD: I think there might have

been a greater disposition along those lines had it

not been for the movement of the so-called "taxes"

"class" of 1948. That class for the first time

really gave companies freedom to have as many

links. At that time the limitation was 3 per cent

of their assets. That was raised to 5 per cent in

the amendments of 1941

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With the expiration of the 5 per cent

margin where they may buy any bond or stock they like

as long as the stock or bond is not in default.



1 and since that provision has been in force now for
2 13 years, I think it must surely have induced in
3 the mind of management to some degree a certain sense
4 of freedom that they never had prior to 1948. At the
5 same time very few companies have exercised that
6 freedom to the extent of the maximum permitted by
7 the Act. Even though they were permitted 3 per cent
8 up to 1961 only one or two companies had approached
9 3 per cent, and they were mainly companies that
10 were interested in income real estate. On the
11 average companies as a whole had only one per cent
12 invested under that provision. Even though the limit
13 is now 5 per cent they still only have 1 per cent
14 invested under it. When we asked the companies when
15 the 3 per cent provision was in force, Why don't you
16 buy this or that under the "Basket Clause" if you want
17 to buy it? Well, they said, we want to reserve our
18 freedom or latitude in case something else comes
19 along. That I think has been answered now; the 5
20 per cent leaves ample scope to purchase almost
21 anything they want.

22
23 COMMISSIONER GIBSON: What I am
24 wondering really is, unless you are going into a new
25 field pretty seriously maybe there is an inclin-
26 ation not to go into it at all because you need
27 specialists and you need to do a lot of work there.

and since that provision has been in force now for 13 years, I think it must surely have induced in the mind of management to some degree a certain sense of freedom that they never had prior to 1948. At the same time very few companies have exercised that freedom to the extent of the maximum permitted by the Act. Even though they were permitted 3 per cent up to 1961 only one or two companies had approached 3 per cent, and they were mainly companies that were interested in income real estate. On the average companies as a whole had only one per cent invested under that provision. Even though the limit is now 5 per cent they still only have 1 per cent invested under it. When we asked the companies when the 3 per cent provision was in force, "Why don't you buy this or that under the 'Basket Clause' if you want to buy it? Well, they said, we want to reserve our freedom or latitude in case something else comes along. That I think has been answered now, the 5 per cent leaves ample scope to purchase almost

COMMISSIONER CLARK: What I am

wondering really is, unless you are going into a new field pretty seriously maybe there is an inclination not to go into it at all because you need specialists and you need to do a lot of work there.



1 Do you think these limitations might affect the
2 general attitude of some companies in saying: Well,
3 we are happy the way we are, why should we try these
4 new areas?

5 MR. MacGREGOR: I do not believe so, sir.
6 I do feel that we have had no indication from the
7 companies that they feel this way. We feel that
8 companies have ample scope now and we have had
9 no indication from the companies that they feel they
10 are hampered or impeded from entering any field
11 that they wish. I know of no complaints on the
12 companies' parts as respects investment provisions
13 at the present time, unless it is with respect to
14 common stocks and, more particularly perhaps, to
15 the valuation of common stocks. I cannot help feeling
16 that not nearly as many companies would buy stocks
17 as some ^{persons} might think now, even if they had complete
18 freedom, or we had a different basis of valuation.

19 There is always, I think, the tendency
20 on the companies' part to ask for more and more
21 freedom whether they want to exercise those provisions
22 or not. For example, income real estate first came
23 on the scene about 1947. At that time our
24 Canadian companies could not invest in real estate
25 for the production of income of the lease-back
26 type, and some American companies were engaging
27 in that field right under the noses of our Canadian
28 companies. We had to amend the laws to let the
29 Canadian companies into this field. That was
30 done by the enactment of the "Basket Clause" at



General attitude of some countries in saying: Well, we are happy the way we are, why should we try there now ahead?

MR. MacGREGOR: I do not believe so, sir.

I do feel that we have had no indication from the companies that they feel this way. We feel that companies have ample scope now and we have had no indication from the companies that they feel they are hampered or impeded from entering any field that they wish. I know of no complaints on the companies' parts as respects investment provisions at the present time, unless it is with respect to common stocks and, more particularly perhaps, to the valuation of common stocks. I cannot help feeling that not nearly as many companies would pay close as some might think now, even if they had complete freedom, or we had a different basis of valuation. There is always, I think, the tendency

on the companies' parts to ask for more and more freedom whether they want to exercise those provisions or not. For example, freedom over future assets on the scene about 1944. At that time our Canadian companies could not invest in real estate for the production of income of the lease-back type, and some American companies were engaging in that field right under the nose of our Canadian companies. We had to amend the law to let our Canadian companies into this field. That was done by the amendment of the "Lease-back" law.



1 the time. A bit later, in 1950 -- two years later --
2 some specific provisions were put in Section 63
3 respecting the so-called income real estate. It
4 was recognized as a particular kind or class of
5 investment on the scene at that time of a desirable
6 type. Immediately the loan and trust companies
7 wanted a provision put in their Acts to cover
8 income real estate. Well, it was put in the Loan
9 Companies Act and the Trust Companies Act in a little
10 more limited fashion, but I do not think a single
11 loan company or trust company even yet has entered
12 into one income-producing real estate deal of
13 the lease-back type. I do not criticize them for
14 it but ^{if} some companies have one provision they all
15 want it, whether they intend to use it or not.

16 COMMISSIONER GIBSON: Well, in respect
17 of the Basket Clause I am not clear from what
18 you have said what your philosophy is here. I
19 got the feeling from some of the things you said
20 that this was to allow companies to do things
21 there were perhaps a little riskier. In your
22 reference to the "Basket Clause" in your brief at
23 page 56 you relate it to the surplus as though
24 perhaps there was more risk in this area, yet in
25 other places you have given me the feeling that
26 this is to give more flexibility of movement in
27 the areas where provision is not made where there
28 is not any more risk than in other areas.

29 MR. MacGREGOR: The latter was the
30 original intention. There was no intention in 1948



the time. A bit later, in 1950 -- two years later --
some specific provisions were put in Section 68
respecting the so-called income real estate. It
was recognized as a particular kind of lease of
investment on the same at that time of a different
type. Immediately the loan and trust companies
wanted a provision put in their Acts to cover
income real estate. Well, it was put in the loan
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more limited fashion, but I do not think a single
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into one income-producing real estate deal of
the lease-back type. I do not estimate then that
it but some companies have one provision they all
want it, whether they intend to use it or not.
CONSULTANTS: Well, in respect
of the Bankers' Clause I am not clear from what
you have said what your philosophy is here. I
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that this was to allow companies to do things
there were perhaps a little better. In your
reference to the "Bankers' Clause" in your brief and
page 56 you relate it to the same as though
perhaps there was some risk in doing so, but in
other places you have given me the feeling that
this is to give more flexibility, or movement in
the areas where provision is not made where there
is not any more risk than in other areas.
MR. MARGHERITA: The latter was the



1 when that provision was enacted that it should be
2 regarded as an invitation really to engage in
3 risky investment, or to make risky investments.
4 Its original purpose was to permit companies to
5 make investments that they believed to be sound
6 even though they did not comply with the technical
7 requirements of the prescribed clauses. Certainly
8 its existence enables companies to make investments
9 that might be of a little riskier type, if they
10 wish to, but that was not the original intention,
11 and frankly they have not.

12 COMMISSIONER GIBSON: Why do you relate
13 it to surplus in talking about it then? Presumably
14 your investment here ought to be as good as other
15 investments?

16 MR. MacGREGOR: That is the way it has
17 worked out. When it was enacted, of course, it
18 was a new provision and although it had been enacted
19 in some state laws to the south, it was new
20 and it was unknown what companies would do under
21 it. For that reason in our thinking we related it
22 to surplus. We thought about half the companies'
23 surplus of 6 per cent would originally be a reasonable
24 provision. As it has turned out it has been used
25 by companies to make good investments, I do believe.
26 There has been no indication that they have used
27 it to buy penny mining stocks or anything of
28 that sort at all.

29 COMMISSIONER GIBSON: So you would not
30 now particularly relate it in your thinking to



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risky investment, or to make risky investments.
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COMMISSIONER OF REVENUE: May do you relate

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MR. MACLEOD: That in the way it has

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surplus of 5 per cent would originally be a reasonable
provision. As it has turned out it has been used
by companies to make good investments. I do believe
there has been no indication that they have used
it to buy penny mining stocks or anything of
that sort at all.

COMMISSIONER OF REVENUE: Do you wish to



1 surplus?

2 MR. MacGREGOR: Not so much, no. One
3 of the early investments that arose was G.M.A.C
4 debentures that were not technically eligible, but
5 nobody at the time questioned the soundness of
6 G.M.A.C. debentures. The companies bought them
7 under the basket provision but they later qualified
8 under the regular prescriptions.

9 I think we are headed more and more toward
10 greater latitude in the investment provisions in the Act.

11 We are not really very far from almost complete
12 freedom. In my own thinking I have felt that it
13 is right that we should grow with the times and
14 that freedom should grow with experience. At
15 the same time, I have felt it right that the greater
16 freedom companies are given in making investments
17 the more realistic our valuation bases should be.
18 To me it is inconsistent to give companies more
19 and more freedom investment-wise and then change to
20 more or less arbitrary valuation bases, whether
21 it be amortized values for bonds or some average values
22 for stocks and so on. I prefer the British system
23 in that respect; with freedom be realistic. That
24 again is only one reason why I adhere rather
25 strongly to the market basis of valuation, not-
26 withstanding what is said against it.

27 COMMISSIONER GIBSON: Well, from what
28 you say you have almost convinced me that there ought
29 to be complete freedom of investment here with a
30 sound valuation approach. What is the objection



surplus?

MR. MACHINER: Not so much, no. The

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COMMISSIONER GIBSON: Well, from what

you say you have almost convinced me that there ought

to be complete freedom of investment here with a



1 to complete freedom? Are there some immature
2 companies around that need to be checked?

3 MR. MacGREGOR: Oh, in time we may grow
4 to it. Perhaps it may not be very far off. I should
5 not like to make a prediction really. I think the
6 provisions of the Act probably have an effect now
7 beyond the insurance field itself. Quite a few
8 pension funds, trusts and so on have their investment
9 provisions written in terms of the Insurance Act.
10 That is just a side effect, of course, not a main
11 one.

12 COMMISSIONER GIBSON: Are there some
13 marginal people in the field that perhaps should not
14 be absolutely free to invest as they please?

15 MR. MacGREGOR: I should not like to point
16 a finger at any on the scene today, Mr. Gibson.

17 COMMISSIONER GIBSON: No, I would not
18 expect you to, but is there a marginal problem still,
19 that is all I am really asking you?

20 MR. MacGREGOR: I think they serve
21 as preventatives and deterrents in some cases, yes,
22 to going overboard for some particular field that
23 may appeal to some management. There is so much
24 variety; some companies are so mortgage-minded
25 they want to put a large proportion of their assets
26 in mortgages. Not many want to be above 40 per
27 cent but one company has 60 per cent and at one
28 time nearly 70 per cent, but others have not wanted
29 to develop a mortgage department to any extent at
30 all, although that is less so now than it used to be.



to complete freedom? Are there some limitations

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may appeal to some management. There is no more

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they want to put a large proportion of their assets

in mortgages. Not many want to be above 10 per

cent but one company has 10 per cent and at one

time nearly 70 per cent, but others have not wanted

to develop a mortgage department to any extent at

all. I think that is why now there is much to be



1 They prefer to keep to corporate bonds and other
2 bonds.

3 COMMISSIONER GIBSON: But you do
4 not impede them in this area at all?

5 MR. MacGREGOR: No, that is true enough.

6 COMMISSIONER GIBSON: One of the things
7 they said to us is that they are very different.

8 MR. MacGREGOR: I beg your pardon?

9 COMMISSIONER GIBSON: This is one of the
10 things that insurance companies said to us, they
11 are very different, and some of them concentrate
12 on mortgages while others concentrate on corporate
13 bonds and so on.

14 MR. MacGREGOR: Yes.

15 COMMISSIONER GIBSON: Going back to the
16 common stock position; the equity position, I would
17 like to go over some of the comments you have made.

18 At page 59 you say that if the insurance
19 companies had purchased more stocks they would not
20 have had as many funds in fact to invest in mortgages.

21 This, of course, is true, but would it
22 matter? Would this be undesirable from the standpoint
23 of the financing pattern in this country?

24 MR. MacGREGOR: Well, of course, we all
25 know that a company can only invest a dollar one
26 way, it cannot invest it twice except successively.
27 I think in fairness to the companies they have been
28 conscious of public policy and public demand for
29 money, where they put their money into government
30 bonds during the war and into mortgages after the war,



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COMMISSIONER GIBSON: But you do

not impose them in this area do you?

MR. MAGNUSON: No, that is true enough.

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MR. MAGNUSON: I beg your pardon?

COMMISSIONER GIBSON: This is one of the

things that insurance companies said to us, that

are very different and some of them corporations

on mortgages while others concentrate on corporate

bonds and so on.

MR. MAGNUSON: Yes.

COMMISSIONER GIBSON: Going back to the

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like to go over some of the comments you have made.

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companies had purchased more stocks they would not

have had as many funds to lend to invest in mortgages.

That, of course, is true, but would it

matter? Would this be undesirable from the standpoint

of the financing pattern in this country?

MR. MAGNUSON: Well, of course, we all

know that a company can only invest a dollar for

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considerations of public policy and public demand for

money, where they put their money in the government



1 and so on. I think they have tried to meet public
2 policy and public demand as best they could.

3 COMMISSIONER GIBSON: Would they not have done
4 that even if there had been somewhat of a
5 tendency to invest in common stocks? You would still
6 expect them to have bought government bonds at
7 certain times and mortgages at others.

8
9 MR. MacGREGOR: I would think that if they
10 had after the war headed toward common stocks instead
11 of mortgages, even if they might have fared well
12 financially out of it, I think they would have
13 attracted far more criticism in doing so. If the
14 public was clamouring for mortgage money, the
15 public could point to the companies and say: They
16 do not give a hoot about us. They are investing
17 in common stocks with the idea of making more profits
18 for themselves or for their companies, but again I
19 am not sure what stocks in volume they would have
20 bought.

21 COMMISSIONER GIBSON: Supposing they made
22 more money, this would have meant that insurance
23 would have been a bit cheaper, perhaps.

24 MR. MacGREGOR: Well, it might have been
25 a little, but I think if they had gone into stocks
26 they would have gone into U.S. and U.K. stocks, not
27 into Canadian stocks, and then again they would
28 have been open to the criticism that they were
29 not investing in Canadian equities to keep control
30 here and so on, or providing equity capital for

and so on. I think they have tried to meet public policy and public demand as best they could.

COMMISSIONER GIBSON: Would they not have done

that even if there had been somewhat of a emergency to invest in common stocks? You would still expect them to have bought government bonds at certain times and mortgages at others.

MR. MACGREGOR: I would think that if they had after the war headed toward common stocks instead of mortgages, even if they might have fared well financially out of it, I think they would have attracted far more criticism in doing so. If the public was clamouring for mortgage money, the public could point to the companies and say: They do not give a hoot about us. They are investing in common stocks with the idea of making more profits for themselves or for their companies, but again I am not sure what stocks in volume they would have

COMMISSIONER GIBSON: Supposing they had

more money, this would have meant that insurance would have been a bit cheaper, perhaps.

MR. MACGREGOR: Well, it might have been a little, but I think if they had gone into stocks they would have gone into U.S. and U.K. stocks, not into Canadian stocks, and then again they would have been open to the criticism that they were not investing in Canadian equities to keep control



1 Canadian industry.

2 COMMISSIONER GIBSON: This would have
3 built up Canadian foreign assets.

4 MR. MacGREGOR: The fact is at the present,
5 although they have less business in the States, of
6 course, than they have in Canada, they have more
7 U.S. stocks than they have Canadian stocks. That
8 has been pretty much the case all along. In other
9 words, U.S. stocks have been more attractive to them
10 than Canadian stocks.

11 COMMISSIONER GIBSON: Do you see anything
12 wrong with that, sir?

13 MR. MacGREGOR: No, I do not. I do not
14 criticize them for it but the point I had in mind
15 is that even if there was no limitation on common
16 stocks, and even if they had a valuation method
17 based on averages or something that would insulate
18 them a bit more from market fluctuations, and if
19 they had invested more money in stocks I think they
20 would have bought U.S. stocks more than Canadian
21 stocks. So then, I suppose, they would have been
22 subject to criticism on two sides: First that they
23 had not provided mortgage money in Canada and,
24 secondly, they were not buying Canadian stocks
25 to help keep control here or to provide equity for
26 Canadian industry and so on.

27 COMMISSIONER BROWN: Presumably if they had
28 done that and had been subject to the criticism
29 they would have changed their pattern, but they did
30 not have the opportunity of being subjected to that



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Canadian industry and so on.

COMMISSIONER BROWN: Presumably if they had

none that and had been subject to the criticism

they would have changed their position, but can't do



1 criticism.

2 MR. MacGREGOR: Well, of course the fact
3 is they could have bought lots more stock if they
4 wanted to. The 15 per cent limitation was no
5 inhibition to them at all. I think it is fair to
6 say also that not nearly so many companies want to
7 buy stocks as some people would believe. Many companies
8 just do not think they are a suitable type of
9 investment for life companies. Certainly the largest
10 U.S. life company is dead against buying any stock
11 whatsoever.

12 COMMISSIONER GIBSON: Yes, but the thing
13 is you make this point in your brief and, therefore, I
14 think it is fair for us to assume that you would think
15 these are significant considerations.

16 MR. MacGREGOR: I do.

17 COMMISSIONER GIBSON: I refer to the
18 limitations that exist in respect of the purchase of
19 stocks.

20 MR. MacGREGOR: Yes.

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1 COMMISSIONER GIBSON: One of the other points
2 your raise is that if they had bought a lot of stocks
3 it might have meant widespread control of
4 Canadian industries by insurance companies. This
5 is possible too, but would that be a bad thing?
6 I mean, perhaps Canadians might be happier than seeing
7 a lot of stocks bought by people outside the country.

8 MR. MacGREGOR: I am not sure, sir. I
9 can only say that wherever that sort of thing seemed
10 to have developed, governments have been rather
11 quick to criticize companies for doing so, and have
12 taken measures to stop it. The Royal Commission here
13 in 1906 was critical of investments that had been
14 made. Even then some Canadian life companies were almost
15 running and owning street railway companies. We see the
16 same thing happened in the United States in the 1930's.
17 We have seen it even more recently in that country.

18 I think managing a life company is a full-
19 time job, and if our companies were to get into a
20 position whereby they controlled all sorts of other
21 kinds of businesses, I think in order to protect their
22 own interest they would have to take some significant
23 part in the management of those companies. Frankly,
24 I do not believe they are equipped to do it, and
25 they should not do it.

26 COMMISSIONER GIBSON: They do not show
27 any particular inclination of wanting to do it.

28 MR. MacGREGOR: No. They have in the
29 past before there were any restrictions. The report
30 of the Royal Commission mentions that in considerable



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1 detail.

2 COMMISSIONER GIBSON: You are really saying
3 that there are a lot of other factors affecting
4 investment policies of insurance companies than
5 market and economic factors. You are really putting
6 quite a lot of weight on what the public thinks and
7 what the government thinks, and various general
8 attitudes which you believe exist. That is correct,
9 is it not?

10 MR. MacGREGOR: I think it is. There is
11 surely a public feeling against big financial
12 interests running the country, in many respects.

13 I think in general that specialization
14 is likely to lead, surely, to more efficient operations.
15 If the life companies stick to the life insurance
16 field, the trust companies to the trust companies
17 field, the banks to the banking field, and so on,
18 there is bound to be more efficient operation. If
19 our life companies were to get into the position
20 where they are running all sorts of industries, and
21 so on, I suppose there would be no reason why they
22 should not be running trust companies and banks if
23 they were big enough, and goodness knows what, but
24 I think the trust companies feel the present situation
25 is best, and I believe the life companies do too, that
26 they stay in their own fields.

27 COMMISSIONER GIBSON: There has been
28 a tendency in the post-war period for people to go
29 into other people's fields. There is quite a
30 broadening in financial activities in various groups.



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a tendency in the post-war period for people to go

into other people's fields. There is quite a

propensity to diversify activities in various groups.



1 MR. MacGREGOR: That is true. I should
2 not think it would be in the best interest of our
3 life companies and their policyholders, however, if they
4 were to get into the position where they were running
5 food chains and rubber tire companies, and goodness
6 knows what kind of companies.

7 COMMISSIONER GIBSON: Of course, you could
8 meet this kind of problem by having some limitation
9 on the proportion of shareholdings of any particular
10 company.

11 MR. MacGREGOR: We have a 30 per cent
12 limit now. No company may purchase more than 30 per
13 cent of the shares of another company. That is designed
14 to keep them from getting control, although even
15 30 per cent might in many cases amount to an effective
16 control.

17 COMMISSIONER GIBSON: On the valuation
18 of equities, common stocks, I understand you value
19 them at market price for annual statement purposes,
20 is that correct?

21 MR. MacGREGOR: That is correct.

22 COMMISSIONER GIBSON: And at book value
23 for calculating the 15 per cent limit?

24 MR. MacGREGOR: That is correct.

25 COMMISSIONER GIBSON: Is there any reason
26 why this should be done on a different basis?

27 MR. MacGREGOR: Of course, book values
28 are generally more stable values. In the main they
29 are cost prices, so that when the limitations are
30 written in terms of book values you have a fairly



MR. MCGREGOR: That is true, I agree.

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1 stable basis for your limitations. If the limitations
2 were written in terms of market values, especially
3 for stocks, the basis would be a good deal less stable.
4 So it makes quite a difference, I must admit, at the
5 present time, on the basis of book values.

6 The highest proportion in any large company
7 is 7.8 per cent in common stocks. On a market basis
8 that same company has 14 per cent. The fact is, of
9 course, they bought many of their stocks quite a while
10 ago at lower prices.

11 COMMISSIONER GIBSON: This method gives
12 more latitude than if you had everything on a market
13 basis.

14 MR. MacGREGOR: Yes, it does.

15 COMMISSIONER GIBSON: And it does not vary very
16 widely in a year?

17 MR. MacGREGOR: That is right.

18 COMMISSIONER GIBSON: Why do you not limit
19 the purchase of preferred shares if you limit the
20 purchase of common shares? Do you regard them as
21 much safer than common stocks?

22 MR. MacGREGOR: I think the answer is there
23 just never seems to have been any need to do so. I
24 think in most cases legislation has followed an
25 apparent need, and the companies never bought preferred
26 shares in great quantities.

27 COMMISSIONER GIBSON: It is not an indication
28 of their superior quality?

29 MR. MacGREGOR: No, I do not think so. They
30 have never been particularly popular.



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1 COMMISSIONER BROWN: May I just clarify
2 a couple of points. The book value of 15 per cent
3 relationship applies only to Canadian companies, does
4 it not?

5 MR. MacGREGOR: It applies also to the
6 assets to be maintained on deposit in Canada by
7 British and foreign companies against their Canadian
8 liabilities -- not on the book value basis.

9 COMMISSIONER BROWN: That is what I mean;
10 with the foreign companies it is the market values.

11 MR. MacGREGOR: That is correct.

12 COMMISSIONER BROWN: So, there could be
13 occasions when they
14 had bought stocks which had gone up in price,
15 when they would have to make a change because the
16 market value had gone up?

17 MR. MacGREGOR: That is right. It is
18 a little harder on British and foreign companies
19 in that respect, or it may appear to be a little
20 harder, but on the other hand there is nothing to
21 prevent the British or foreign companies from buying
22 all the stocks they like.

23 COMMISSIONER BROWN: I just wanted to
24 clarify that position.

25 MR. MacGREGOR: That is right.

26 COMMISSIONER BROWN: Does the basket clause
27 apply to foreign companies as well?

28 MR. MacGREGOR: Yes, it does.

29 COMMISSIONER BROWN: Does this put, to
30 that extent, the foreign companies in a slightly better



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1 position than the Canadian companies, in that foreign
2 companies have to have these percentages applied
3 against their liabilities, whereas in the Canadian
4 companies they apply against the whole liability
5 position, including surplus?

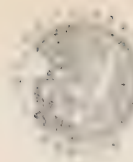
6 MR. MacGREGOR: The basket provision in
7 the case of British and foreign companies, the 5 per
8 cent now, applies to the market value of the assets
9 they have deposited against their Canadian liabilities.

10 COMMISSIONER BROWN: That is what I mean,
11 that the foreign companies can use this basket clause
12 up to 5 per cent against their liabilities to policy-
13 holders?

14 MR. MacGREGOR: Yes.

15 COMMISSIONER BROWN: With respect to the
16 Canadian companies, the 95 per cent has to apply
17 against their whole picture, including surplus, so
18 that if the foreign companies are able to keep their
19 surplus out of the country in any other category they
20 wish, why should not the Canadian companies be given
21 wider leeway with respect to the proportion of their
22 liabilities which is not directly against their
23 policyholders, in other words their surplus?

24 MR. MacGREGOR: I think, looking at it
25 the other way, that is concentrating on the basket
26 latitude itself, the Canadian companies may put 5 per
27 cent of their total assets, which means 5 per cent
28 of their liabilities plus 5 per cent of their surplus,
29 into any form of investment they like. You might
30 say in the case of the British or foreign companies



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MR. MACGREGOR: The basket provision in the case of British and foreign companies, the 5 per cent now, applies to the market value of the assets they have deposited against their Canadian liabilities. COMMISSIONER BROWN: That is what I mean, that the foreign companies can use this basket of up to 5 per cent against their liabilities to policyholders?

MR. MACGREGOR: Yes.

COMMISSIONER BROWN: With respect to the Canadian companies, the 25 per cent has to apply against their whole picture, including surplus, so that if the foreign companies are able to keep their surplus out of the country in any other category they wish, why should not the Canadian companies be given wider leeway with respect to the proportion of their liabilities which is not directly against their policyholders, in other words their surplus?

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1 they might put only 5 per cent of their liabilities
2 alone, if their liabilities and assets are the same.

3 COMMISSIONER BROWN: Is it not the other
4 way around, and that is that in fact you control 95 per
5 cent, and 5 per cent is left free?

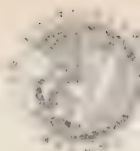
6 MR. MacGREGOR: Yes.

7 COMMISSIONER BROWN: Now, if the Canadian
8 companies just had to have control on 95 per cent
9 of their liabilities, they would have the other 5 per
10 cent of their liabilities, plus the whole of their
11 surplus, free for anything.

12 MR. MacGREGOR: Yes, that is correct. That
13 is right. However, I do not think it is a practical
14 point, sir, because none of the Canadian companies
15 has come anywhere near the 5 per cent latitude that
16 they now have open to them.

17 COMMISSIONER BROWN: No, but my point
18 is that if the surplus were available in the same
19 category as the basket, in other words, if the other
20 requirements were against their liabilities to
21 policyholders, it would give them greater
22 freedom, would it not, and at the same time it would
23 still keep them in the same position as the foreign
24 companies?

25 MR. MacGREGOR: I do not think in practice
26 there is any significant difference between the two.
27 The Canadian company may put 5 per cent of its total
28 assets in investments under the basket clause. A
29 foreign company may put 5 per cent of its deposits
30 in whatever form it likes, and it can put anything
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1 COMMISSIONER BROWN: But the Canadian companies
2 are not permitted head office investment leeway.

3 MR. MacGREGOR: That is right.

4 COMMISSIONER BROWN: What are the ranges
5 in the basket clause now in Canadian companies?

6 MR. MacGREGOR: I have not the figures
7 with me but I would say none exceeds 3 per cent.

8 COMMISSIONER BROWN: I just wondered in
9 this whole discussion if there had been any thought
10 of giving greater leeway in the basket clause for
11 Canadian companies which had a fairly large surplus.

12 MR. MacGREGOR: They have ample room now,
13 sir. I do not think the companies themselves feel
14 they are restricted in the slightest way so far
15 as the basket clause is concerned. Every single company
16 has a lot of latitude under that clause yet that has
17 not been taken up.

18 COMMISSIONER MACKINTOSH: Is it your
19 impression, Mr. MacGregor, that since the provision
20 was made for segregated pension funds that the life
21 companies have lost interest in an increase in the
22 common stock percentage of 15 per cent?

23 MR. MacGREGOR: Oh, most certainly. That
24 was recognized even at the time of the amendments.
25 When they asked for the 25 per cent, that is when
26 we were still discussing the segregated fund question,
27 and when we agreed to support their views as respects
28 segregated funds, it is my recollection, impression
29 and, in fact, understanding that the 25 per cent was
30 pretty well forgotten about. It was never pushed by

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1 the companies after that. The existence, of course,
2 of that amendment respecting segregated funds effectively
3 gives them a great deal more latitude to buy common
4 stock because it let them into the pension field
5 where they really wanted to buy common stocks, and
6 they have complete freedom there under that amendment.

7 COMMISSIONER BROWN: The proportions you
8 look at are with respect to the overall picture.

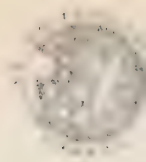
9 MR. MacGREGOR: Yes. They are not just
10 Canadian assets.

11 COMMISSIONER BROWN: Do you run into any
12 situation where the requirements of a foreign juris-
13 diction cause a certain dislocation as far as Canadian
14 assets are concerned; in other words, whether
15 percentages might be different in some foreign juris-
16 diction which throws things out so far as the Canadian
17 policyholders are concerned?

18 MR. MacGREGOR: No, there are no serious
19 troubles there. Our companies are authorized under
20 the Act to deposit in foreign countries sufficient
21 to cover their liabilities there, or even to go beyond
22 that if the laws of the foreign countries so require it.

23 COMMISSIONER BROWN: You imply that
24 this takes place in United States, that there are
25 cases where they have to deposit assets in excess
26 of liabilities?

27 MR. MacGREGOR: The rules governing deposits
28 vary a great deal. In United States they are
29 pretty strict in that respect. There is usually a
30 state of entry recognized for each company entering



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1 the United States. Michigan has been a favourite
2 state, and the deposits are set up under an agreement
3 originating there. The United States has been quite
4 strict in the amounts of deposits required. Our life
5 companies have had no difficulty meeting them, of
6 course. In the fire and casualty field, notwithstanding
7 the apparent law, some of the states, especially
8 New York, have been very strict and seem to exercise
9 quite a bit of administrative discretion too. Not
10 many of our Canadian fire and casualty companies
11 do business outside Canada, and those that do are
12 mainly in the United States of America.

13 In New York State they pretty well say,
14 "You put up assets two to one compared with your
15 liabilities, and if you do not want to put it up you
16 can not do business here."

17 On the other hand, in Great Britain, of
18 course, they make either a nominal deposit or no
19 deposit at all, so that overall, if a company is
20 doing business in Britain and the United States, its
21 assets out of Canada are considerably less than its
22 liabilities.

23 The basket clause has certainly served a
24 useful purpose where companies are operating in foreign
25 fields too because quite understandably good invest-
26 ments arise in other countries for which we have
27 no counterpart here, and the old prescriptions just
28 do not fit in some cases. But under the basket clause
29 they are empowered to make investments in foreign
30 fields without any particular difficulty.

the United States. Michigan has been a favorite
state, and the deposits are set up under an agreement
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1 I mentioned one point in my submission,
2 to harp back again to this question of control of
3 that
4 companies, /although suggestions have been made recently
5 that this prohibition against life companies buying
6 shares of another life company should be removed,
7 our Canadian fire and casualty companies were in
8 exactly the same position back in the 1920's. There
9 was a lot of concern then because a lot of
10 Canadian fire and casualty companies were being
11 bought up by United States and British fire and
12 casualty companies and it looked as though all our
13 purely Canadian fire companies, or most of them,
14 might disappear with the proportion in their hands
15 getting down to 4 per cent in 1925.

16 There were similar suggestions at that
17 time that something be done to stop the trend
18 and, on the recommendation of the then Superintendent
19 of Insurance, an amendment was made to the Act in
20 Section 64 respecting Canadian fire and casualty
21 companies that gives such companies the power to buy
22 the shares of another fire and casualty company.
23 But that legislation has not been particularly effective.
24 There is only one case I can think of at the present
25 time where a Canadian fire and casualty company still
26 owns another Canadian company, and it is quite a
27 small one. It is rather ironical that certain large
28 Canadian fire and casualty companies operating in a
29 group, as they have always done, which
30 pressed the hardest for that amendment in the 1920's, were
bought out in their entirety last year by a British
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1 We in the Department have heard all
2 sorts of suggestions as to what should be done, and
3 I must say that some of them are pretty drastic; even to
4 prohibit shareholders from selling their shares to
5 foreigners.

6 COMMISSIONER BROWN: On the matter of
7 valuation, would you tell us briefly how mortgages
8 are valued and how they fit into this whole picture
9 of amortized values, book values and market values?

10 MR. MacGREGOR: For all practical
11 purposes one can say that mortgages are carried on
12 the books of the company at the balance of principal
13 outstanding. In other words, at their full value.

14 There is a question of reserves against mortgages,
15 and that has been the technique, the valuation technique,
16 so to speak, to carry the mortgage at its full face
17 value and set up any necessary reserves in the
18 liabilities, unless the mortgage gets so bad
19 that it has to be written down or written off, but
20 mortgages haven't been a particular problem at all
21 for valuation purposes in recent years.

22 Back in the 1930's it was a very serious
23 problem. At that time many of our companies had
24 significant amounts in western farm mortgages and
25 also in city mortgages that had gone sour. Certainly
26 I personally paced a good deal of pavement in those
27 years looking at foreclosed real estate, et cetera,
28 and it was an individual problem in each case to set
29 up what seemed to be an appropriate reserve against
30 this mortgage and that mortgage, and so on.



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1 Where interest fell in arrears in those
2 years, most companies stopped charging it up for
3 balance sheet purposes after two years. In the eyes
4 of the mortgagor, of course, the interest was
5 accumulating, but no company ever carried any more
6 than two years overdue mortgage interest.

7 Mortgages were written down in those
8 years depending upon an individual assessment or
9 appraisement of each mortgage, and an appropriate
10 reserve was set up in the liabilities. Happily,
11 it hasn't been a problem in recent years or since
12 the war, and I think that most of us hope that it
13 will not arise.

14 I think it is much less likely with
15 the amortization base that we have for practically
16 all mortgage loans now, the principal is steadily coming
17 down and even if trouble develops in any particular
18 case -- apart from the newest mortgages -- there is
19 not likely to be a serious problem. But in the 1930's
20 the situation was so very different; the mortgages
21 had been made in the 1920's and they were not on
22 an amortized basis, they called for certain nominal
23 amounts of principal to be repaid on May 1 and November 1,
24 and the companies were not strict in enforcing these
25 provisions and the loans went on for years without
26 reduction at all in the principal amount, and then
27 when they did fall in arrears the indebtedness was
28 high and many of the properties were found to be in
29 a poor state of repair. Even when foreclosed it
30 cost a lot of money to put them back in shape to rent



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1 or to sell them -- actually, they couldn't sell them --
2 but nowadays the situation is so much sounder with
3 the amortization basis and the equity of the mortgagor
4 is steadily increasing.

5 COMMISSIONER BROWN: But for valuation purposes,
6 they carry it on book value?

7 MR. MacGREGOR: Yes.

8 COMMISSIONER BROWN: And to that extent it
9 is not related to any market value because of the
10 difficulty involved?

11 MR. MacGREGOR: That is right, there is
12 no market problem in valuation there.

13 As a matter of fact, the whole basis of
14 argument as to an appropriate valuation method seems
15 to me to be less important or less significant
16 nowadays than it was years ago when companies had
17 more of their assets in bonds. Now they have such
18 a significant proportion of mortgages, nearly 40 per cent,
19 which are not subject to market fluctuations for balance
20 sheet purposes and they are protected as respects
21 government bonds, which are permitted to be carried
22 at amortized values. They have policy loans which
23 constitute on the average 5 per cent of their assets
24 which are not subject to market fluctuations at all.
25 In other words, the part of the company's balance
26 sheet that is exposed to market fluctuations is
27 considerably smaller than it was in times gone by,
28 so they are pretty safe from serious shock from
29 market changes unless, of course, they go heavily
30 into equities, and they are exposed there.

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1 COMMISSIONER BROWN: What is the average
2 of this reserve for market values that is set up?

3 MR. MacGREGOR: Most companies at the
4 end of 1961 were not required to set
5 up anything. Of course, the practice now -- as I
6 explained in my submission, or tried to -- is not
7 to write down the assets or make a deduction from
8 the assets, but to earmark an investment reserve,
9 to earmark some general or investment or contingency
10 reserve, -- by whatever name it may be called --
11 and in that way to make provision for any
12 deficiency of the market under book. Thus at the end
13 of the year it doesn't mean that the surplus is
14 bouncing all over the lot, it means that a part of
15 their present reserve is marked to cover the
16 deficiency and the amount of the reserve in the balance
17 sheet still stays the same.

18 At the end of 1961 most companies were in
19 a position where their market values were above their
20 book values. At the end of 1960 quite a few companies
21 had to earmark an investment reserve to cover a
22 deficiency at that time. If they had anything much
23 in stocks at all, even a small amount, the appreciation
24 there has offset to a large extent the deficiency on
25 the bond account.

26 COMMISSIONER BROWN: I gather most companies
27 don't have a reserve for market values?

28 MR. MacGREGOR: Most of them don't have
29 it as such; it doesn't appear in the balance sheet as a
30 reserve for market values. Most companies will have



COMMISSIONER BROWN: What is the average

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1 their surplus and some general investment or contingency
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4 year, they will indicate in parenthesis -- in fact,
5 they are instructed to do so -- they will indicate
6 in parenthesis that part of the general or invest-
7 ment or contingency reserve that is required to cover
8 the deficiency.

9 COMMISSIONER BROWN: Is the
10 reserve set up from the operating profit or
11 capital gains, or both?

12 MR. MacGREGOR: Both. Companies have
13 followed different policies in writing down their
14 assets. There has always been strict opposition
15 all round to anything in the nature of writing up
16 the book value of a company's assets. On the
17 other hand, when it comes to writing them down,
18 companies have generally written down the book value
19 where it is believed that intrinsic depreciation has
20 been suffered. If a bond has gone in default and
21 the situation is bad, the practice has been to write
22 the book value down, but some companies nevertheless
23 have applied capital profits in very substantial
24 amounts to write down the book values of either new
25 securities purchased or the values of securities
26 already on hand and, of course, companies in that
27 position almost always have a very substantial excess
28 of market over book value.

29 COMMISSIONER BROWN: There is a slight
30 contradiction on pages 65 and 67, and I assume you don't



their surplus and some general investment or contingency reserve as well as some profit sharing, no market values are less than book values at the end of any year, they will indicate in parentheses -- in fact, they are instructed to do so -- they will indicate in parentheses that part of the general or investment or contingency reserve that is required to cover the deficiency.

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MR. MACHOLM: Both. Companies have followed different policies in writing down their assets. There has always been strict application all round to anything in the nature of writing up the book value of a company's assets. On the other hand, when it comes to writing down book value, companies have generally written down the book value where it is believed that intrinsic depreciation has been suffered. If a bond has gone in default and the asset is bad, the practice has been to write the book value down, but some companies nevertheless have applied capital profits in very substantial amounts to write down the book values of either new securities purchased or the values of securities already on hand and, of course, companies in that position almost always have a very substantial excess of market over book value.

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1 really mean it. At page 65 you refer to market value
2 being the more realistic value for common stocks, and
3 at page 67 you refer to market values or book values,
4 if they are lower, as being the more realistic. I
5 assume you mean the same would apply to common stocks?
6 In other words, if book value is below the market
7 value you assume the book value is still more realistic
8 than the market value?

9 MR. MacGREGOR: I didn't intend there to
10 be an inconsistency. My thought is that market
11 value is more realistic, and is perhaps the most
12 realistic, but the practice of taking the assets
13 at book or market, whichever is lower, is the more
14 conservative, and therefore better on that account.

15 COMMISSIONER BROWN: I didn't think you
16 meant quite that.

17 MR. MacGREGOR: I am sorry if I misled
18 you there.

19 COMMISSIONER BROWN: At page 73 you
20 refer to the current dividend formula. Could you
21 just outline this for us? You say that there may
22 be reasons for reconsidering the current dividend
23 formula in certain contingencies?

24 MR. MacGREGOR: Well, I was speaking there
25 of dividends to policyholders, of course.

26 COMMISSIONER BROWN: That is right.

27 MR. MacGREGOR: In the older -- may I
28 start back a little earlier -- most of the life
29 business done in Canada is done on what is called "a with
30 profits" or participating basis. Although most of

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MR. MACGILLIVRAIR: In no other -- may I

start back a little earlier -- most of the life
business done in Canada is done on what is called "a with-
drawing" or participating basis. Although most of



1 our life companies have until recently been joint
2 stock companies most of their business nevertheless
3 is participating business; three-quarters, seventy-
4 five or eighty per cent of their business was partici-
5 pating, and although they were joint stock companies
6 they were doing mainly a mutual business. At the
7 same time, they have had a substantial volume of non-
8 par business.

9 In the older days the difference between
10 the two was quite marked. The participating
11 premiums of the companies had quite substantial
12 margins in them, and most companies just offered
13 the two series; non-par, the rock bottom, guaranteed,
14 no dividends, and par with a good margin. They were
15 called the old standard par rates. That was
16 in the 1920's, broadly speaking.

17 Then, in the 1930's there was a move
18 to offer other alternative series of par policies.
19 They would continue to offer the old standard par,
20 but if you wanted an intermediate series you could
21 take a participating policy with a lower premium,
22 and that developed to the point where some companies
23 were issuing par policies with a very, very small
24 margin in them. They were very close to non-par
25 policies.

26 There were some series issued in those
27 years called modified par policies, but they had
28 different names. They were non-par for the first
29 ten years or even longer, and par thereafter.

30 The point which I am trying to make is that

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1 we have got quite a variety of participating business
2 on the books now; different series of policies with
3 different margins in the premiums.

4 Where companies issue par business
5 with a good margin in it, this is a wonderful source
6 of strength, of course, if the company runs into
7 difficult times because the margin in the premiums
8 produces good earnings for the company and it can
9 cut its dividends to the policyholders if need be,
10 and this is exactly what happened in the 1930's when
11 several companies were facing difficult times. In
12 fact, when they were using so-called authorized
13 values for balance sheet purposes, being the market
14 values or other values used in the last preceding balance
15 sheet, the Department as a condition of using these
16 values laid down certain rules, namely, that companies
17 couldn't increase their scale of dividends to policy-
18 holders or increase their scale to the shareholders,
19 and in the odd year one of the conditions was that
20 they couldn't pay any dividends to shareholders. Consequently

21 in those years the companies -- in order
22 to recoup their strength -- changed their dividend
23 formula, reduced their dividends to policyholders, and
24 cut down their shareholders dividends.

25 That can still be done and it would be
26 done if a company gets into a difficult position,
27 but I don't think companies have quite the same
28 flexibility now in that respect that they used to have
29 because there is not nearly as much par business
30 written with a relatively large margin as there used

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1 to be, but that doesn't exactly answer the question,
2 I know, that you have in mind. On this page I
3 mention that if the situation were serious enough
4 they would have to reconsider their dividend formula;
5 they would simply have to reduce it.

6 Most companies follow what is called a two
7 or a three factor formula in computing their policy-
8 holders' dividends. One factor is related to the
9 rate of interest and another to the rate of mortality,
10 and the third to the loading for expense.

11 If the policy was written on, say, a
12 $3\frac{1}{2}$ per cent basis, and its guaranteed values throughout
13 are on the $3\frac{1}{2}$ per cent basis, but if the company is
14 earning $4\frac{1}{2}$ per cent -- roughly speaking an extra
15 one per cent earned on the policy reserve -- this would
16 be one of the elements contributing to the dividend,
17 but also the mortality savings in respect to that
18 particular class of policy are computed, and this is
19 the second factor contributing to the dividend. These
20 and other factors are observed and followed in
21 normal times, but if a company through investment
22 policy, or whatever the reason, got into a ^{difficult} financial
23 position, you would have to suspend theory and cut
24 these dividends even arbitrarily.

25 COMMISSIONER BROWN: I asked my question on
26 a too general basis. What I was really getting
27 at was, on these mutual companies which don't pay out all
28 of their surplus each year in dividends;
29 do they keep adding surplus?

30 MR. MacGREGOR: There are two aspects there,

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3 1/2 per cent basis, and its guaranteed values throughout

are on the 3 1/2 per cent basis, but if the company is

earning 4 1/2 per cent -- roughly speaking an extra

one per cent earned on the policy reserve -- this would

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MR. INSURER: There are two aspects there,



1 sir, I think; competition forces them, of course,
2 to produce a net cost comparable to their main
3 competitors; it is true they cannot pay out what they
4 are not earning, but the position of our companies
5 generally today is better and stronger than it was,
6 say, before the war or even in some cases right after
7 the war.

8 The surplus position of some companies
9 ten years ago or so was not as strong as desirable,
10 and these companies, of course, were in a bit of a
11 dilemma; you have to produce a net cost and pay
12 out dividends that will produce a net cost comparable
13 to your competitors, and at the same time there is
14 that strong desire on their part to build up their
15 surplus position-- not to put surplus away unnecessarily -
16 but to get it up to a standard equal to that of their
17 main competitors and that which is thought desirable.

18 It is a matter of opinion, of course,
19 what surplus and free /a company should have; in the
20 life field it is completely different from the fire
21 and casualty field. By and large I think that most
22 companies would like to have a free surplus and
23 reserve position of about $7\frac{1}{2}$ per cent. If it is
24 less than 6 per cent, most of them want to get it
25 up at least to that.

26 COMMISSIONER BROWN: I suppose what I am
27 really getting at is to whom does this surplus in a
28 mutual company go; if a participating policyholder
29 dies, does his estate get any part of the surplus?
30 To whom does the surplus belong?

air, I think; competition forces them, of course,

to produce a net cost comparable to their main

competitors; it is true they cannot pay out what they

are not earning, but the position of our companies

generally today is better and stronger than it was,

say, before the war or even in some cases right after

the war.

The surplus position of some companies

ten years ago or so was not as strong as desirable,

and these companies, of course, were in a bit of a

dilemma; you have to produce a net cost and pay

out dividends that will produce a net cost comparable

to your competitors, and at the same time there is

that strong desire on their part to build up their

surplus position-- not to put surplus away unnecessarily,

but to get it up to a standard equal to that of their

main competitors and that which is thought desirable.

It is a matter of opinion, of course,

what surplus and free $\frac{1}{2}$ company should have; in the

life field it is completely different from the first

and casualty field. By and large I think that most

companies would like to have a free surplus and

reserve position of about $\frac{1}{2}$ per cent. If it is

less than 6 per cent, most of them want to get it

up at least to that.

COMMISSIONER BROWN: I suppose what I am

really getting at is to whom does this surplus in a

mutual company go; if a participating policyholder

does, does his estate get any part of the surplus?

To whom does the surplus belong?



1 MR. MacGREGOR: In a mutual company the
2 surplus all belongs to the policyholders. In a
3 stock company the surplus in the non-par fund belongs
4 to the shareholders. The surplus in the par fund
5 belongs, in the main, to the par policyholders,
6 although a share of it belongs to the shareholders.
7 The share is governed by a section in the Act.

8 COMMISSIONER BROWN: How can a participating
9 policyholder get his share of the surplus?

10 MR. MacGREGOR: In many cases they pay
11 a mortuary dividend, and in some cases a dividend
12 on surrender.

13 COMMISSIONER BROWN: Is this a standard
14 procedure?

15 MR. MacGREGOR: This is a frequent or
16 common procedure, but it is not universal. There
17 are some companies that have not enough surplus
18 to pay such a dividend.

19 COMMISSIONER BROWN: If they are not doing
20 this, should there be some maximum point at which
21 this surplus should be allowed to accumulate?
22 I cannot see how anyone can get it unless it is
23 on maturity or a policyholder dies.

24 MR. MacGREGOR: In the U.S.A., back in
25 1905 there was a feeling -- and I think with some
26 justification, perhaps -- that some companies were
27 withholding surplus that should be distributed
28 to policyholders, so they wrote a limit in the law.
29 That has been changed and bandied around, until
30 now in New York State there is a limit of 10 per

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MR. MACGREGOR: In the U.S.A., back in

1905 there was a feeling -- and I think with some justification, perhaps -- that some companies were withholding surplus that should be distributed to policyholders, so they wrote a limit in the law. That has been changed and amended several times.

Now in New York State there is a limit of 10 per



1 cent of the liabilities or \$750,000, whichever
2 is the greater. It is of no practical application here
3 at all. Over the years we have had no difficulty
4 with companies building up too much surplus. I
5 can only recall one instance where we did take
6 the initiative in rather criticizing a small mutual
7 company for seemingly withholding too much surplus.
8 Competition pretty well looks after the field
9 as a whole. A company cannot build up too much
10 surplus. The agents alone are quick to point to
11 the surplus and say, "Why don't you increase our
12 dividends and improve our net cost, and so on? Then
13 we will sell far more."

14 In the fire and casualty field the situation
15 is completely different. A good standard in the fire
16 and casualty field is not 6 or 7½ per cent of the
17 company's liabilities, but almost a surplus equal
18 to its liabilities. That is the generally accepted
19 standard of a fire and casualty insurance company
20 in a good position. They have assets about twice
21 the liabilities, but it is subject to far more
22 serious fluctuations and catastrophe hazards than
23 a life company is.

24 In fact, in our Act there is a section which
25 limits dividends in a fire and casualty insurance
26 company until its surplus equals its unearned premium
27 reserves.

28 COMMISSIONER BROWN: I was not discussing
29 so much the surplus of stock companies or surplus
30 with respect to the shareholders of life companies,

cent of the liabilities or \$150,000, whichever is the greater. It is of no practical application here at all. Over the years we have had no difficulty with companies building up too much surplus. I can only recall one instance where we did take the initiative in rather criticizing a small mutual company for seemingly withholding too much surplus. Competition pretty well looks after the field as a whole. A company cannot build up too much surplus. The agents alone are quick to point to the surplus and say, "Why don't you increase our dividends and improve our net cost, and so on? Then we will sell far more."

In the fire and casualty field the situation is completely different. A good standard in the fire and casualty field is not 6 or 7 1/2 per cent of the company's liabilities, but almost a surplus equal to its liabilities. That is the generally accepted standard of a fire and casualty insurance company in a good position. They have assets about twice the liabilities, but it is subject to far more serious fluctuations and catastrophe hazards than a life company is.

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so much the surplus of stock companies or surplus with respect to the shareholders of life companies,



1 but more the surplus with respect to the participating
2 policyholders of stock and mutual companies. I think
3 you have covered that.

4 MR. MacGREGOR: Competition pretty well
5 provides the answer there.

6 THE CHAIRMAN: What is the method of
7 calculating the amounts of a dividend to be paid
8 in the event of the death of a policyholder out of
9 the surplus? Is that something that the directors
10 of the company can determine, or is there some formula
11 that applies?

12 MR. MacGREGOR: It is a pretty complicated
13 matter, sir.

14 THE CHAIRMAN: Is it a formula of some
15 kind?

16 MR. MacGREGOR: Yes. It is not willy nilly;
17 there is a particular formula.

18 THE CHAIRMAN: I do not want you to go
19 into all the details of the formula, because I
20 am sure I could not understand that.

21 MR. MacGREGOR: It is by formula. I might
22 sum up my own thoughts on the life companies by
23 saying that I think one of their greatest attributes
24 is their strength, and yet through it all they are
25 not too strong. I do not think they have withheld
26 surplus to the detriment of their policyholders.
27 Happily, most of them are in quite a satisfactory
28 position now. Of course, times have been good.
29 Business has come readily since the war, and has
30 expanded rapidly. Recently there have been signs

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1 of poor persistency, but investment conditions
2 have been good, and all the conditions affecting
3 life companies have been relatively favourable
4 ever since the war, so it is perhaps not surprising
5 they have made good progress.

6 If I may, I might provide the answer to
7 one question that arose when the Canadian Life
8 Insurance Officers' Association presented their
9 brief. One Commissioner asked what proportion
10 of the business is presently done in the life field
11 by companies that were registered 30 years ago.
12 If one looks at new business issued and focuses
13 attention on the life companies registered at the
14 end of 1931 that are still doing business in Canada
15 today -- and practically everyone of them is -- such
16 companies did 91 per cent of the total new business
17 transacted in Canada in 1961. If one looks at
18 the business in force, the life companies that were
19 on the scene in 1931 still have 93 per cent of the
20 total life business in force in Canada today.

21 In other words, although we have had many companies
22 entering the field since 1931 they presently do
23 only 9 per cent of the new business and have only
24 7 per cent of the business in force in Canada.

25 Another question related to the number
26 of companies that have entered the field since 1931,
27 30 years ago, and the number that have withdrawn.
28 I am speaking, of course, of federally registered
29 companies only, but they cover all the British
30 and foreign companies. If one combines life, fire

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Another question related to the number of companies that have entered the field since 1931, 30 years ago, and the number that have withdrawn. I am speaking, of course, of federally registered companies only, but they cover all the British and foreign companies. If one compares life, fire



1 and casualty and fraternal benefit societies, there
2 were 377 such companies and societies licensed at
3 the end of 1931. At the end of 1961 there were
4 454, indicating a net increase of 77. But that
5 net increase of 77 companies and societies covers
6 the entry of 292 companies and societies and the
7 withdrawal of 215. Thus, there has been quite an
8 influx and quite a withdrawal. I can give the
9 figures, if you are interested in them, separately
10 for life and fire and casualty. Briefly, however,
11 there has been quite a number of U.S. life insurance
12 companies entering Canada just to service overflow
13 group business. That is, where, they had a master
14 group life policy with some company or companies
15 in the States that had a subsidiary or branch
16 office up here, and having issued a group
17 policy in the States they want to cover also the
18 Canadian employees, they have sought and obtained
19 registration in Canada to cover that business. Quite
20 a number of U.S. companies have come in for that
21 purpose. On the other hand, quite a large number
22 of the 215 companies withdrawing are fire and
23 casualty companies that have withdrawn through
24 consolidation or mergers rather than for other
25 reasons. We had a very large number of U.S. companies
26 operating here in the fire and casualty field --
27 separate companies, but operating in groups. That
28 situation arose through the laws of the various
29 states until relatively recent years. Until recently
30 in the States a fire insurance company could not do

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1 automobile insurance and vice versa, and so on.

2 If you had a company dealing, say, in automobile or fire
3 insurance and you wanted to get into some casualty
4 line you often had to set up a separate company.
5 The result was that there were groups of companies
6 under common management.

7 Since the war those laws have been changed
8 down there, to permit fire and automobile insurance
9 and casualty insurance to be transacted in the
10 same company, with the result that many
11 companies have been consolidated and merged.

12 There is another explanation I might
13 mention, because it explains the large number of
14 withdrawals, to a significant extent also. Back in
15 the 20's, by the rules of the Canadian Underwriters
16 Association here in the fire and casualty field
17 a company could only have one agent in a certain
18 area. This was to protect the agents, of course.
19 If a company wanted another agent in that area
20 the only way to have another agent was to have another
21 company, so they either formed or brought in an
22 associated company from their home territory. We
23 had what we call, in many cases, fleets of companies
24 or "pups". Those rules have been changed now.
25 In the interests of economy -- and economy has been
26 one of the factors inducing it -- these fleets
27 of companies and groups have been steadily consolidated.
28 They were under common management and, usually, common
29 ownership anyway, but they have been merged and
30 consolidated, and that explains a great many of the

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1 apparent withdrawals. The companies are still here,
2 but they are under one name instead of several
3 names.

4 COMMISSIONER HARROLD: On page 28, you
5 say:

6 "In a nutshell, the basic principle
7 of our legislation is that the deposit
8 system for out-of-Canada companies, together
9 with publicity and inspection of all companies,
10 will secure adequate protection for the
11 public."

12 You end up by saying:

13 "... experience has provided ample
14 justification for it."

15 -- the present legislation on restrictions, and so on.
16 And yet, as far as experience has shown, I believe
17 you say there is no company that has actually failed
18 to meet its obligations under the present provisions.
19 Do you not think this suggests there could be some
20 easing of the restrictions or regulations in that
21 case?

22 MR. MacGREGOR: I do not think so. There
23 have been several instances where companies got
24 into trouble in their home jurisdiction; but we
25 had here, in Canada, enough assets on deposit to
26 cover the Canadian liabilities of the company, so
27 there was no loss to Canadian policyholders. However,
28 there have been cases where the home policyholders
29 of that company lost.

30 Our whole purpose is to ensure that there

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COMMISSIONER HARROLD: On page 28, you

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apparent withdrawals. The companies are still here,



1 are enough assets held in Canada that may be drawn
2 on to protect Canadian policyholders, if that is
3 necessary. I did not intend anything in my submission
4 to indicate that while many companies have withdrawn
5 or disappeared, for one reason or another, they all
6 just went out in the natural course. Several went out
7 through failure, but fortunately we had enough
8 assets to look after Canadian policyholders, and
9 we arranged for re-insurance of the Canadian portfolio
10 of the business with another solvent company.
11 That is by far the best solution if a company gets
12 into difficulty, because it avoids any discontinuity
13 in coverage of policyholders, and they continue
14 with the new company the same as they did with the
15 old.

16 Most of our work in the Department, in
17 supervision, is directed at that very thing, namely,
18 to ensure that each company has on hand now, and
19 will as far as we can see continue to have enough
20 assets to cover its liabilities. In many cases,
21 certainly in the insurance field, the worst problem
22 is not to value their assets. You can depend on
23 it that most companies will reveal their assets.
24 The big problem is to ascertain what their true
25 liabilities are. They are the most subtle and,
26 sometimes, almost nebulous things, and by far
27 the most difficult to appraise. That is where I
28 think the real value in our work lies, to make sure,
29 or as sure as we can, that all the companies' liabilities
30 are revealed and are properly appraised.

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1 The other side of the coin arises subsequently;
2 see to it that they have enough assets to cover those
3 liabilities. I know of a good many instances where
4 we have had to arrange for the re-insurance of
5 a foreign company in difficulty; and we have, up
6 to date, been able to catch them in time, so to
7 speak, so that there are enough assets to interest
8 another company in taking over the portfolio. I
9 might mention that some very interesting situations
10 arise.

11 COMMISSIONER HARROLD: Which part of the
12 legislation do you consider the more valuable --
13 inspection or assets?

14 MR. MacGREGOR: I think the two go hand-in-
15 hand. I think inspection is, because the existence
16 of a "police-force" probably keeps most of us
17 on right paths in our day-to-day life. I think
18 the mere knowledge on a company's part that examiners
19 may come in at any time is, surely, a strong deterrent
20 to doing anything, even if a company was otherwise
21 disposed to do something, that might not be right.
22 Inspection comes first; and, secondly, I think you
23 must back it up then, having determined the liabilities,
24 by assets that you can use to cover those liabilities.

25 I may say that in our examination work
26 we never arrange or announce or indicate, in any
27 fashion, to a company when we are going in. The
28 examiners knock on the door and go in without any
29 prior indication whatsoever. The very first thing
30 they do is to take control of the vault and count

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1 the securities. We try to keep our work meaningful,
2 and try to get in and out as quickly as possible,
3 to inconvenience the companies the least possible
4 amount. We have certainly over the years, nevertheless,
5 endeavoured to be a friendly "police-force", to work
6 with the companies, but we have certainly, at the
7 same time, maintained our independence, and nothing
8 has ever been tolerated in the department in the
9 nature of the acceptance of any favours or anything
10 of that sort with the companies.

11 COMMISSIONER HARROLD: I notice, in your
12 section on investigation of complaints, that on
13 page 31 you say;

14 "... and no case is recalled
15 where the complainant has afterwards
16 gone to Court."
17
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COMMISSIONER HAROLD: I notice, in your

section on investigation of complaints, that on page 31 you say:

"... and no case is recalled

where the complainant has afterwards

gone to Court."



1 This does not suggest, apparently, that no policy-
2 holders have gone to court?

3 MR. MacGREGOR: No, sir. If we find,
4 when a policyholder writes, that the case is already
5 before the courts, we of course simply say that we
6 cannot intervene at all. There are very few such cases.
7 In most cases we have been very successful in bringing
8 about a meeting of minds between the company and the
9 policyholder. There is usually misunderstanding on
10 one side; usually it is the policyholder who mis-
11 understands. But, perhaps being a government de-
12 partment, they may accept our explanation, where they
13 may not be disposed to accept the company's; I do
14 not know. But in fact, anyway, we have had, I
15 believe, a high degree of success in bringing about
16 an understanding and an end to the complaint. At
17 the same time, I cannot say that we are always success-
18 ful. Over the years it is rather strange how particular
19 complaints arise. I would not like to call the
20 complainants cranks, but a few individuals over the
21 years have given us an enormous amount of trouble.
22 Our conclusion is that they just cannot be satisfied
23 and the correspondence is endless with these people.
24 Mortality usually provides the answer in time.

25 COMMISSIONER HARROLD: They receive a
26 higher judgment. Would you say there are a con-
27 siderable number of complaints? Is quite a lot
28 of the work in your department taken up with this
29 kind of thing?

30 MR. MacGREGOR: No, sir. It is rather

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1 strange, and yet perhaps understandable. Complaints
2 come in waves and they depend, seemingly, a good deal
3 upon economic conditions.

4 For example, in the thirties we had a
5 great volume of complaints where people were out of
6 work, or hard up and were not paying their premiums
7 and, perhaps it is inevitable, their policies fell
8 into arrears. Some of them lapsed, and so on. It
9 is inevitable that there would be a lot of complaints
10 in those circumstances. Or they want to cash them
11 in and they do not get all they think they should get.
12 Perhaps in those years, too, people had more time
13 to complain and were more disposed to complain.
14 In any event, we had all sorts of complaints. In
15 better times, since the war, we have not had a volume
16 anything like the volume of the thirties. I should
17 not like to say that the complaints average more than
18 one a day; no more than one a day, I would think,
19 at the present time.

20 COMMISSIONER HARROLD: You say that the
21 function the Department performs is of an extra-
22 statutory nature; in other words, it is not included
23 in the statute.

24 MR. MacGREGOR: No, sir.

25 COMMISSIONER HARROLD: This has just grown
26 up as something that the Department has decided
27 it should handle.

28 MR. MacGREGOR: Yes; it is something we
29 feel, really, we cannot refuse to handle. If a
30 policyholder writes to us, a government department,

strange, and yet perhaps understandable. Complaints come in waves and they depend, seemingly, a good deal upon economic conditions.

For example, in the thirties we had a great volume of complaints where people were out of work, or hard up and were not paying their premiums and, perhaps it is inevitable, their policies fell into arrears. Some of them lapsed, and so on. It is inevitable that there would be a lot of complaints in those circumstances. Or they want to cash them in and they do not get all they think they should get. Perhaps in those years, too, people had more time to complain and were more disposed to complain. In any event, we had all sorts of complaints. In better times, since the war, we have not had a volume anything like the volume of the thirties. I should not like to say that the complaints average more than one a day; no more than one a day, I would think, at the present time.

COMMISSIONER HAROLD: You say that the function the Department performs is of an extra-statutory nature; in other words, it is not included in the statute.

MR. MACGREGOR: No, sir.

COMMISSIONER HAROLD: This has just grown up as something that the Department has decided it should handle.

MR. MACGREGOR: Yes; it is something we feel, really, we cannot refuse to handle. It is

policyholder writes to us, a government department,



1 and registers a complaint, I think it is in the interests
2 of all, the companies and the public and the policy-
3 holder, that we should take time off to look into it.

4 There is nothing in the statute about
5 that kind of work. It is not a large part of our
6 work; but I think, nevertheless, it is an important
7 part. Even a few complaining policyholders can do a
8 lot of harm if they are not answered. I think it is
9 best that they should be answered. I think we do
10 it effectively, without spending very much time or
11 money on it.

12 We have, of course, one avenue that
13 enables us to do it well. If we receive a complaint
14 we may be able to write to the company, to the head
15 office, about it. But quite frequently it is
16 desirable that we should have one of our examiners
17 drop into the company's head office and look into
18 the company's files right there. We get to the
19 bottom of the information at first-hand, and our
20 examiner can talk to the company management about it
21 to get their side of the story on the spot. It is
22 more satisfying, I think, to the policyholder if he
23 can be told our examiner has visited the company and
24 discussed it and looked at its files and records,
25 and we can say plainly what we believe to be the
26 situation. We have that ready entre to the company
27 that others have not.

28 THE CHAIRMAN: We shall adjourn until
29 1.45 P.M. Is that convenient?

30 MR. MacGREGOR: Oh, yes, sir.

--- Luncheon Adjournment.

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1 --- Upon resuming at 1.45 P.M.

2 THE CHAIRMAN: We will now continue.

3 COMMISSIONER LEMAN: Mr. MacGregor, this
4 morning we discussed the insurance companies nearly
5 exclusively; not entirely, because you made a
6 couple of references to trust companies during the
7 discussion. I should like now to turn to the
8 loan and trust companies. I notice, beginning on
9 page 90 of your memorandum, that you discuss there
10 a little bit the difficulty of distinguishing what
11 is truly a banking business and what is not.

12 We have had a lot of discussion about
13 that and I do not think we want to discuss that
14 point as such. However, in relation to that I
15 should like to ask you a few questions.

16 When institutions such as the ones we
17 are talking about accept, especially demand deposits,
18 it becomes that much more difficult to distinguish
19 their business from that of a banking business,
20 so, without solving the thorny question itself,
21 would there nevertheless, in your view, be a case
22 for federal supervision, at least of all sectors
23 involved in the deposit business?

24 MR. MacGREGOR: I would think there might
25 be, or would be, Mr. Leman. One of the difficulties
26 from the point of supervision is that the companies
27 doing that kind of business, not now supervised
28 by our department, are provincial creatures ---

29 COMMISSIONER LEMAN: I would like to avoid
30 any discussion of constitutional problems here.

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by our department, are provincial creatures ---

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any discussion of constitutional problems here.



1 MR. MacGREGOR: I was not going to mention
2 that.

3 COMMISSIONER LEMAN: All right.

4 MR. MacGREGOR: In practice, the supervision
5 of provincial companies is a bit troublesome as
6 such. We have had quite a little experience now
7 supervising provincial companies of one kind or
8 another. From years back we have some provincial
9 insurance companies still registered, although
10 it has not been the practice to register them for
11 many years. But in the loan and trust field we
12 do supervise, and have supervised, for some years
13 the provincial loan and trust companies in three
14 provinces. Those companies are not licensed by
15 us; we have no authority to license them. We
16 supervise them simply by reason of agreements
17 made between the respective governments. In other
18 words, we perform inspections in place of provincial
19 officials.

20 We have received complete co-operation
21 from those companies. We have had no problems
22 whatsoever from that point of view.

23 COMMISSIONER LEMAN: May I interrupt
24 for a second. When you perform inspections, then
25 it becomes your duty to apply the provincial law
26 under which they ---

27 MR. MacGREGOR: That is the point I am
28 getting to. When one is supervising the operations
29 of an entire company, as we do in supervising
30 a Dominion corporation, the corporation is subject

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1 only to Dominion laws, really; at least, so far
2 as its corporate powers are concerned, and the
3 main Act under which it operates is a Dominion
4 statute.

5 But when we supervise provincial creatures,
6 even though not licensed by us and therefore not
7 subject to any Dominion, general statute, we have
8 to familiarize ourselves, not only with the act
9 of incorporation of each of these provincial
10 companies -- and there is actually a great deal
11 of variety amongst them -- but we find that those
12 provincial companies are not only subject to maybe
13 one general Act in the province, maybe the Trust
14 Companies Act of the province, but they may be
15 subject to two or three other general acts, the
16 Companies Act of the province and perhaps some other
17 general acts.

18 So it is quite a problem in fact, in
19 some cases, to ascertain with certainty just what
20 their powers are and what restrictions they are
21 subject to. Each case is almost an individual
22 problem. That is why I say they give rise to quite
23 a little work. And then, of course, if a provincial
24 company is licensed by the Federal government in
25 such a fashion that it accepts conditions as a
26 part of the license -- it accepts conditions
27 in a general act of the federal government -- it
28 is a little more difficult still, because you
29 have got the creature deriving its powers from
30 a province and it is subject to two sets of restrictions,

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one General Act in the province, maybe the Trans Companies Act of the province, but they may be subject to two or three other general acts, the Companies Act of the province and perhaps some other general acts.

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1 and the provincial set is usually more difficult
2 to ascertain with certainty than the federal.

3 As a practical problem, it is pretty
4 troublesome.

5 COMMISSIONER LEMAN: But in any particular
6 problem, then, you have to make sure you apply
7 the most restrictive of any kind of legislation?

8 MR. MacGREGOR: That is correct. That
9 is the situation we are in, in respect of provincial
10 insurance companies that are registered. In the
11 loan and trust field, I admit we have not been
12 faced with that problem because, as I say, these
13 provincially owned trust companies are not licensed
14 by us. So it is purely a question of supervising
15 them from the point of view of their own governing
16 statutes. There is not a large enough number of
17 them to make it an insuperable problem.

18 In the trust field, for example, there
19 are at present about 50 trust companies operating
20 in Canada, provincial and federal, of which 15
21 are now supervised by us. There are about 35
22 other trust companies, provincially incorporated
23 in every case, operating. But this is not a number
24 that is beyond the realm of practical supervision.
25 In the loan field the number involved is even
26 smaller than that.

27 COMMISSIONER LEMAN: Mr. MacGregor, if
28 you, as you have explained to us, accept the
29 responsibility, or if it is given to you, to supervise
30 the entire operation of a company, that is one problem.



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the operation of a company, that is the problem.



1 Then if we home-in on this problem of doing a deposit
2 business, would there be anything practical in
3 saying that -- would it practical for you to supervise
4 them in so far as their deposit business, or guaranteed
5 fund business is concerned, only without supervising
6 the whole company?

7 MR. MacGREGOR: Oh, yes.

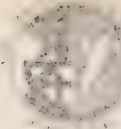
8 COMMISSIONER LEMAN: Or does that introduce
9 another problem again?

10 MR. MacGREGOR: No, I do not think so.
11 I think it would be quite practicable to supervise
12 trust companies mainly to the extent of their guaranteed
13 trust funds, namely, deposits, guaranteed investment
14 certificates, etc.

15 COMMISSIONER LEMAN: But then you would
16 need a certain guidance as to what sort of rules
17 should be applied to that business?

18 MR. MacGREGOR: There ought to be some
19 uniform rules, I should say, yes, if the federal
20 government were to have any official responsibility
21 in that connection. In the trust field I have rather
22 got the impression that the companies themselves
23 wish there were more uniformity in the rules governing
24 provincial trust companies as compared with federal.
25 Certainly the rules of the provinces in incorporating
26 trust companies have been by no means uniform.

27 I think the situation is better now,
28 in some respects, than it was. For example, 20
29 years or so ago, when we first took over the supervision
30 of trust companies in Manitoba, we sent our examiners



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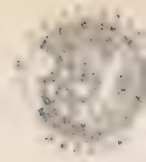
in some respects, than it was. For example, 20 years or so ago, when we first took over the supervisory



1 around to look into every company that had the word
2 "Trust" in its name, and we sought the assistance
3 of the provincial authorities there to ferret out
4 all the provincial trust companies, and we had
5 a very long list. But when our examiners called
6 upon those companies, and when we got their various
7 instruments of incorporation, we found that most
8 of them were not trust companies at all; they were
9 not doing a trust business and they were not authorized
10 to do a trust business.

11 So the field was very much more limited
12 than it first appeared. Briefly, it was the
13 practice, apparently, for many years to let companies
14 use the word "Trust" in their names even though
15 they were not trust companies. And, rather strangely,
16 only within the last month it came to our attention
17 that a trust company -- not a company, but a provincial
18 corporation -- a trust corporation, so-called anyway,
19 appeared to be operating right on Sparks Street
20 here in the City of Ottawa, holding itself out
21 as rental agent and owning a building, and so on;
22 and when we enquired about it, we found that ten
23 years ago, in 1952, it was formed as a registered
24 partnership. It was never even incorporated.
25 But that company is holding itself out to the public
26 as a regular trust corporation. Things of that
27 kind are, I think, undesirable from the point
28 of view of the public; it is misleading, I think,
29 and confusing.

30 That is just a side-line, quite apart from



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1 corporate powers and restrictions, but things
2 of that kind are, I think, better avoided.

3 I think, without appearing to be a central-
4 izer, some uniformity of rules applicable across the
5 field is in the interests of the whole trust
6 field.

7 COMMISSIONER LEMAN: If we focus our
8 attention, again, a little bit on the question of
9 their doing the business of accepting deposits,
10 and if one of the reasons, or the reason, for
11 federal supervision of that activity seemed necessary,
12 what do you think then would be an appropriate way
13 of dealing with this?

14 Banks, because they do banking, are
15 subject now to certain cash ratios and liquidity
16 ratios because of the nature of their banking
17 operations. If these people were deemed to be
18 doing a banking business, would it be through the
19 same kind of regulation that they should be controlled;
20 something like cash ratios and liquidity ratios,
21 rather than the more general approach you have
22 of protecting lenders and depositors of these
23 companies, which is based on a ratio of debt
24 to capital and reserves?

25 MR. MacGREGOR: I think that both would
26 be desirable. We have, in our federal statutes now, the
27 Loan Companies Act: for example, provisions limiting
28 debt in relation to capital and reserves, and we
29 have also a provision respecting liquidity. Some
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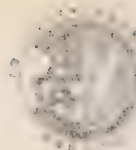
1 not in the best form, in that it embraces municipal
2 bonds as well as school bonds, and so on.

3 I admit that. It is an old provision
4 that has been there for a long time. But, again,
5 it has never been changed because it has been no
6 problem. The loan companies operating under it
7 have always maintained in liquid form securities
8 and cash very considerably above the 20 per cent;
9 double that, or more than that.

10 In the trust field we have not got a
11 liquidity provision in the Trust Companies Act.
12 We have got along very well without any. The
13 trust companies have, as a matter of practice, always
14 maintained resources in the form of cash or liquid
15 securities to a sufficient extent in their view,
16 and in our view, to meet all reasonable demands
17 for payment.. But what the situation would be
18 in a lot of other provincial trust companies or
19 loan companies, with which I admit we are not
20 intimately familiar today, frankly , I would be
21 reluctant to say.

22 Over-all, I would think it better to
23 have both provisions in any governing legislation. -
24 At least, to start out that way, anyway.

25 COMMISSIONER LEMAN: We have heard a lot
26 about the possible alternative between federal
27 supervision against striving for more uniform
28 provincial legislation and supervision practices,
29 control practices, and I think most of those who
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1 Probably they have not the constitutional problem
2 in mind. What, in your view, would be the definite
3 advantages of federal supervision?

4 MR. MacGREGOR: From the purely practical
5 standpoint, I think perhaps we are one of the
6 very few government departments in the country
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1 MR. MacGREGOR: I say that without intent
2 to cast any reflection upon some of the provinces
3 that have good staffs, but there are many more pro-
4 vinces that really have no examination staff at all.
5 Knowing the problems of building up an examination
6 staff of that kind, I think they would be faced with
7 a very difficult problem in doing it.

8 COMMISSIONER LEMAN: You are thinking
9 about efficiency now, aren't you?

10 MR. MacGREGOR: Hiring the people to visit
11 the companies with adequate knowledge to make a proper
12 examination of the companies. In the main I think
13 provincial companies not licensed by our Department
14 have up to date been examined and supervised by the
15 province of incorporation. That has not always been
16 so, although the practices of the various provinces
17 have varied immensely in respect of inspections.

18 COMMISSIONER LEMAN: Well, now, so far
19 as your present jurisdiction is concerned, you comment,
20 at pages 88 and 89, on the request that has been
21 voiced before this Commission for raising the ratio
22 of debt to paid up capital and reserve from $12\frac{1}{2}$ times
23 which is the present limit to 15 times, and you express
24 opposition to this. First of all, would you say this
25 is now primarily a matter of judgment more than any-
26 thing else?

27 MR. MacGREGOR: I think many of these rules
28 are a matter of judgment and opinion. This limit of
29 $12\frac{1}{2}$ times, although it does look like 8 per cent
30 of the debt has, of course, no relation whatsoever to

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1 the 8 per cent cash reserve of the banks although it
2 was referred to in that light in one of the submissions
3 I noticed before the Commission. This limiting
4 ratio of debt to capital started out in a very
5 much more stringent fashion, of course, than exists
6 today. Originally the ratio was four to one. In
7 fact, for deposits it was one to one. Over the years
8 as the companies grew and matured, that limit has
9 steadily been relaxed; four, to six, to seven and
10 then to ten, and then to $12\frac{1}{2}$ more recently. The
11 companies have been pressing for more and more
12 latitude in that respect. The 15 times request
13 is not new. It was made at the time of the last
14 amendments to the Loan Companies Act and Trust
15 Companies Act, and it was considered at that time --
16 two or three years ago, but at that time the existing
17 limit was ten times. We in the Department felt that
18 $12\frac{1}{2}$ was as far as it was reasonably safe to go.

19 Many of the companies I have no doubt would
20 like the limit as high as possible because it enables
21 them to expand their businesses without raising more
22 capital. With their expansion, in some cases quite
23 rapid expansion, in the last ten years, they have
24 had to raise more capital, but the present limit of
25 $12\frac{1}{2}$ times ensures only a safety margin of 7.4 per
26 cent of assets for creditors. It does not seem to us
27 that that is anything too much, and companies I notice
28 are themselves pressing for a 6 per cent mortgage
29 reserve. They are presently permitted 3 per cent,
30 but in their view it is wholly reasonable that they

the 8 per cent cash reserve of the banks although it was referred to in that light in one of the submissions I noticed before the Commission. This limiting ratio of debt to capital started out in a very much more stringent fashion, of course, than exists today. Originally the ratio was four to one. In fact, for deposits it was one to one. Over the years as the companies grew and matured, that limit has actually been relaxed; four, to six, to seven and then to ten, and then to $12\frac{1}{2}$ more recently. The companies have been pressing for more and more latitude in that respect. The 15 times request is not now. It was made at the time of the last amendments to the Loan Companies Act and Trust Companies Act, and it was considered at that time -- two or three years ago, but at that time the existing limit was ten times. We in the Department felt that $12\frac{1}{2}$ was as far as it was reasonably safe to go. Many of the companies I have no doubt would like the limit as high as possible because it enables them to expand their businesses without raising more capital. With their expansion, in some cases quite rapid expansion, in the last ten years, they have had to raise more capital, but the present limit of $12\frac{1}{2}$ times ensures only a safety margin of 1.4 per cent of assets for creditors. It does not seem to us that that is anything too much, and companies I notice are themselves pressing for a 6 per cent mortgage reserve. They are presently permitted 5 per cent, but in that view it is wholly responsible that they



1 should build up reserves against mortgages to the
2 extent of 6 per cent.

3 COMMISSIONER LEMAN: This is for tax pur-
4 poses?

5 MR. MacGREGOR: This is for tax purposes
6 but, nevertheless, they build it up in their balance
7 sheets. I do not think they want to build it up
8 just to avoid taxes. They want to build it up because
9 they feel that a reserve of that order is reasonable
10 and justifiable. Well, I think a reserve of that
11 order is equally necessary against bond fluctuations
12 and other investment fluctuations.

13 COMMISSIONER LEMAN: Do you have any
14 views on that request for raising the mortgage reserve
15 yourself?

16 MR. MacGREGOR: Well, under present
17 conditions certainly a 6 per cent reserve does not
18 seem necessary, but if we look back at the thirties
19 we needed a reserve of more than 6 per cent at that
20 time. I would think it not unreasonable.

21 COMMISSIONER LEMAN: Well, to go back to
22 the $12\frac{1}{2}$ times, you just say you feel that is ample
23 under present circumstances and you are not saying
24 it is too high now?

25 MR. MacGREGOR: No.

26 COMMISSIONER LEMAN: You are just saying
27 it is high enough?

28 MR. MacGREGOR: That is correct, yes.
29 It is just a matter of opinion, but I personally have
30 never in this connection felt that I could support a



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the 12½ times, you just say you feel that is ample

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it is too high now?

MR. MACGRUBER: No.

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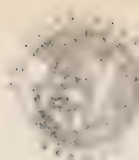
1 higher ratio than that. I think the position of
2 depositors would be thinned down too much.

3 COMMISSIONER LEMAN: Can you tell us some-
4 thing about whether the average liabilities of these
5 companies as a group has tended to shorten since 1947,
6 or is there a larger element of demand deposits in
7 total funds used?

8 MR. MacGREGOR: Well, in loan companies
9 practically all deposits are chequing deposits. There
10 is only a very, very small proportion that are time
11 deposits. So, from that point of view there is no
12 shortening possible. In the trust field, I do not
13 think there has been any significant change in the
14 average length or period of the certificate. They
15 are three, five, ten year certificates in the main.

16 COMMISSIONER LEMAN: What I am driving
17 at, Mr. MacGregor, is this. Is the ratio now too
18 blunt an instrument or would it make more sense to
19 have something a little more refined that would refer
20 to liabilities of a certain length, and demand liabilities,
21 et cetera, and refine it a little more? Let us
22 say that companies have liabilities averaging five
23 years and over the course of a decade or so their
24 liabilities would get down to an average of one year,
25 say, or six months. Do you think that if one ratio
26 makes sense under a certain set of circumstances
27 it still makes sense under a new set of circumstances?

28 MR. MacGREGOR: I would not think so, sir.
29 While trust companies and loan companies too are
30 enjoying reasonable earnings these days they have not



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COMMISSIONER LEMAN: Can you tell us some-

thing about whether the average liabilities of these companies as a group has tended to shorten since 1914, or is there a larger element of demand deposits in total funds used?

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extending their liabilities these days they have not



1 the resiliency in their earning capacity that life
2 insurance companies have. They have no margins of
3 the kind that life insurance companies have in their
4 premiums whereby if they have to encounter troublous
5 days they may reduce or eliminate their dividends to
6 policyholders. Loan and trust companies are not
7 in that position. They are in a more rigid position.

8 Another thought that I might mention
9 in connection with the limiting ratio is this. It
10 has been pointed out to us; put up to us in the past
11 from time to time that the banks without any limit
12 do in fact go further; that their apparent ratio may
13 be roughly 19 times rather than $12\frac{1}{2}$ times. I per-
14 sonally have never put too much stock in that because
15 for one thing, one does not know the inner reserves
16 which banks have which do not show on the surface.
17 If they were taken into account the ratio would not
18 be 19 times but something less than that. How
19 much less I am not certain.

20 Also, I have felt that the position of
21 banks is altogether different having regard to their
22 relationship to the Bank of Canada and so on. Loan
23 and trust companies are really on their own as far
24 as any question of last resort is concerned.

25 COMMISSIONER LEMAN: Is it true though
26 that usually they tend to maintain what appears to
27 be an adequate line of credit with the bank?

28 MR. MacGREGOR: I might say that although
29 we have the rule in our Act of $12\frac{1}{2}$ times and although
30 some provinces have had similar rules, they have not

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Another thought that I might mention in connection with the limiting ratio is this. It has been pointed out to us; put up to us in the past from time to time that the banks without any limit do in fact go further; that their apparent ratio may be roughly 19 times rather than 12½ times. I personally have never put too much stock in that because for one thing, one does not know the inner reserves which banks have which do not show on the surface. If they were taken into account the ratio would not be 19 times but something less than that. How much less I am not certain.

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MR. MACGREGOR: I might say that although we have the rule in our Act of 12½ times and although some provinces have had similar rules, they have not



1 all had such rules, by any means. In some cases,
2 provinces have tended to follow federal legislation.
3 Nova Scotia, for example, throughout its whole Trust
4 Companies Act has copied ours from the start almost
5 verbatim, and their limits are or have been in the
6 main the same as ours.

7 In Ontario and Quebec they have had
8 no such limits, although Ontario I believe only
9 within the last year or so has written in similar
10 limits to federal legislation.

11 Sometimes the companies federally super-
12 vised were inclined to say, well, look at the Quebec
13 companies. They, of course, are very large ones
14 and have no such limits. But, the fact is, those
15 big Quebec provincial trust companies never went
16 beyond, in practice, the limits in our Act. I
17 doubt whether they are above ten times yet.

18 COMMISSIONER LEMAN: How is the limit
19 applied in practice; as of a certain date, or do they
20 have to maintain it constantly?

21 MR. MacGREGOR: Well, the Act is constant, of
22 course. Primarily we check their position at the
23 end of every year when they file their annual
24 statements, but if they are approaching the limit
25 we, of course, have correspondence with them and
26 usually we find that they have already taken some
27 steps to increase their capital, if they have in mind
28 going on.

29 We have encountered the odd case where
30 through a falling market, or through some other reason --



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1 some special fluctuations in deposits -- they have
2 exceeded the statutory limit, ^{but} it has not been a serious
3 problem yet.

4 In one case I can think of a couple of
5 years ago they had a lot of special money, but they
6 very easily repaid and reduced the volume of borrowed
7 money sufficiently to come within the statutory
8 limit.

9 I should not like to leave the impression
10 that we only look at companies once a year. Naturally
11 one gets to know companies. One has in mind pretty
12 constantly in the insurance field the weaker companies,
13 or the companies with special problems, or in the
14 trust company field, the companies that are always
15 crowding, or always seem to have been crowding the
16 borrowing limit, and naturally we are in more frequent
17 touch with those companies. I would say we are up to
18 date in all cases with every company so far as its
19 borrowing limit is concerned.

20 COMMISSIONER LEMAN: Do you feel that a
21 company that is not subject to that limit would have
22 a very substantial competitive advantage over one that
23 has to abide by it?

24 MR. MacGREGOR: I do not think so, sir.
25 I don't know of any companies not subject to such a
26 limit that have ever exceeded the limit applicable
27 to our companies. Of course, opinions change with
28 experience. I can recall company managers of great
29 prominence who at one time felt ten times was the
30 ultimate limit to go to, but I never until recently heard

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1 any of them express the view that one ought to go beyond
2 12 or 12½ times. The last request for 15 has come
3 as an industry proposition, so to speak, but I think
4 it is fair to say, in fairly recent years, several
5 company managers felt that 12 times or 12½ times was
6 just about the furthest one should go.

7 COMMISSIONER LEMAN: Unless ~~another~~ members
8 of the Commission have other questions about this
9 sector, I would like to go on to another.

10 Now I would like to talk a little bit
11 about co-operative credit societies, Mr. MacGregor.

12 COMMISSIONER BROWN: Have you left the
13 small loan companies?

14 COMMISSIONER LEMAN: I did not have any
15 questions to ask about that subject.

16 COMMISSIONER BROWN: I wonder if I could
17 ask one question in respect of small loan companies,
18 Mr. MacGregor?

19 MR. MacGREGOR: Yes, indeed.

20 COMMISSIONER BROWN: This is something I
21 found a little confusing when they were before us.
22 As I understand the statute it provides that when
23 a person or his spouse has a loan from a small loan
24 company of less than \$1,500 and they wish to borrow
25 additional to bring the total loan above \$1,500
26 maximum that the provisions of the act still apply
27 and the interest rate on the amount above \$1,500 has
28 a maximum of one-half of one per cent per month?

29 MR. MacGREGOR: It does extend above in
30 certain circumstances such as that. Where a person



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1 and his spouse both borrow the two are treated as one
2 person.

3 COMMISSIONER BROWN: We asked them this
4 question and they told us that it just did not occur
5 because in fact they would pay off one loan and make
6 a new loan in excess of \$1,500 and thereby not have
7 any limit apply at all.

8 MR. MacGREGOR: That is possible.

9 COMMISSIONER BROWN: Now, is this contrary
10 to the intent of the Act, in fact?

11 MR. MacGREGOR: Perhaps it is, but in
12 practice we have never felt able to prevent it. I
13 can say it has never come to us as a frequent occurrence.
14 It may happen. I have no doubt it does happen, but
15 where a person wants to repay his loan and does in
16 fact repay the loan, and he gets a new loan, we have
17 felt that we must accept those circumstances. I
18 would be very doubtful that in fact--I doubt if this
19 is a common occurrence. It is not a problem which
20 we have been aware of.

21 COMMISSIONER BROWN: They were quite open
22 about it. They said this is the way it was done.

23 MR. MacGREGOR: Is that so?

24 COMMISSIONER BROWN: And the thought
25 naturally arises, whether the \$1,500 limit should be
26 in there. In other words, whether all loans should
27 be controlled of this type.

28 MR. MacGREGOR: Well, that, of course,
29 raises --

30 COMMISSIONER BROWN: What are the problems



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1 that would arise if you did this, this is what I
2 want to ask you about?

3 MR. MacGREGOR: Well, that raises quite
4 a big problem, or a big question. What ceiling is
5 desirable in respect of small loans? Until 1956
6 the ceiling in the Act was \$500. It was raised to
7 \$1,500 at that time. In most of the states of the
8 United States of America the ceiling is less than
9 \$1,500. There are a few states where the ceiling
10 is higher; \$2,500, and perhaps \$4,000 in one state,
11 but by and large most of the state laws set a ceiling
12 of \$1,000 or \$800. In New York State it is \$800.

13 I would say that our ceiling of \$1,500
14 in comparison with small loans legislation on this
15 continent is relatively high. It is higher than the
16 average, certainly.

17 Part of the theory, of course, has been
18 that the Act was designed to protect the smaller
19 fellow; the small borrower, and that those borrowing
20 more substantial sums should be better able to look
21 after themselves.

22 Of course, with the passage of time, with
23 inflation, it was natural that ceilings should rise
24 and they have risen in legislation of this kind on
25 this continent. If the ceiling were to be raised
26 further it is a matter of opinion where it should be
27 set; whether it should be \$2,000 or \$2,500 or even
28 higher.

29 COMMISSIONER BROWN: Well, the question
30 that follows from that is, what would happen then?



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1 Would it mean that these people could not borrow
2 from small loan companies, or would therefore be
3 driven into some other media? We notice that in
4 the statistics one of the large companies in the field
5 makes no loans above \$1,000 because of the higher rate
6 that they generate on loans that do not go above
7 \$1,000. Does this mean that people would be forced
8 to go to two loan companies and therefore pay
9 exorbitant rates anyway on the two loan basis?

10 MR. MacGREGOR: No, I don't think so.

11 COMMISSIONER BROWN: Or would it mean
12 that they just would not be able to borrow?

13 MR. MacGREGOR: The small loans industry
14 has shown quite an ability to adapt itself to small
15 loans laws. In the U.S.A. it is the practice there
16 to license every office, not just the company, but
17 every office. Their laws generally prohibit licensees
18 from making loans above the statutory ceiling.
19 For example, in New York State a small loans licensee
20 is not permitted to make a loan above \$800. That has
21 never been the situation in Canada. The situation
22 here is that small loans licensees may make loans
23 of any amount they desire, but the Act applies only
24 to loans within the specific area in the Act, at
25 the present time up to \$1,500. Sometimes when it
26 is mentioned that a company does not make loans above
27 \$1,000 there may be an associated company that is
28 operating only in the field / ^{over} \$1,500 and, therefore,
29 is not a licensee under the Act. In fact, our
30 largest lender has been in that position for years. It

would it mean that these people could not borrow from small loan companies, or would there be driven into some other way? The notice that in the statistics one of the largest companies in the field makes no loans above \$1,000 because of the higher rate that they generate on loans that do not go above \$1,000. Does this mean that people would be forced to go to two loan companies and therefore pay exorbitant rates anyway on the two loan basis?

COMMISSIONER BROWN: Or would it mean that they just would not be able to borrow?

MR. MATHRESON: The small loan industry has shown quite an ability to adapt itself to small loans laws. In the U.S.A. it is the practice there to license every office, not just the company, but every office. Their laws generally prohibit licenses from making loans above the statutory ceiling. For example, in New York State a small loan license is not permitted to make a loan above \$500. That has never been the situation in Canada. The situation here is that small loan licenses may make loans of any amount they desire, but the Act applies only to loans within the specific area in the Act, at the present time up to \$1,000. Sometimes when it is mentioned that a company does not make loans above \$1,000 there may be an associated company that is operating only in the field of \$1,500 and, therefore, is not a licensee under the Act. In fact, our latest finding has been in that position for years. If



1 has had two companies with almost identical names,
2 one being a licensee operating within the area governed
3 by the Act and the other not being a licensee operating
4 in the field above.

5 At the time of the amendments in 1956 the
6 industry felt that the amendments then proposed were
7 unduly severe; far too severe, and many opinions
8 were expressed that they would simply all be out of
9 business. That has not proved to be the case. We
10 have more licensees now than we had at that time.
11 The number of offices is increasing by about 100 a year
12 across the country. I do not mean licensees, but
13 branch offices.

14 It is true that by reason of the relatively
15 low rate of one-half of one per cent that applies
16 to the layer of loans between \$1,000 and \$1,500,
17 licensees have not been very active in that area,
18 but there is a considerable volume of lending done
19 in that area, for all that. However, lenders tend to
20 put their money where it is most profitable to put
21 it, and they have put most of it in those areas. Although
22 they have not exercised themselves in the particular
23 area between \$1,000 and \$1,500 to the extent they
24 have below \$1,000, and even above \$1,500, we have
25 not received, so far as I can recall, a single com-
26 plaint since 1956 from any borrower that he could
27 not get a loan between \$1,000 and \$1,500. Of course,
28 with the banks coming into the field since then,
29 and with the expansion of credit unions and so on,
30 borrowers are not entirely dependent upon the small
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Division of Banking
Federal Reserve Bank of New York

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with the banks coming into the field since then,
and with the expansion of credit unions and so on,
borrowers are not entirely dependent upon the bank.



1 COMMISSIONER BROWN: Would you have any
2 suggestions to make about increasing the permissive
3 rate above the \$1,000, and supplementary to that
4 a change in the maximum limit and also a change in
5 the permissive rates?

6 MR. MacGREGOR: I shouldn't like at the
7 present time to make any recommendation, sir, in
8 that respect.

9 I mentioned a moment ago something about
10 the ability of the industry to adapt itself to changed
11 rules, changed conditions and even more severe
12 limitations. Perhaps these figures might be of
13 interest to you. I notice that when the credit unions
14 were before the Commission some questions were asked
15 about the manner in which, or the proportions in
16 which the income of the credit union is spent; how
17 much goes for this and that purpose and this and
18 that expense. In the small loans field -- and
19 this is taking all licensees together and covers
20 not only the area of loans up to \$1500, but all
21 their business -- in 1955 the average income
22 expressed as a percentage of average assets during
23 1955, the average income was 21.4 per cent. In 1961
24 the ratio was 18.6 per cent. It has dropped nearly
25 3 per cent by reason, mainly, of course, of the
26 reduction in the maximum rates that they may charge.

27 At the same time, the average assets
28 have increased from \$180 million in 1955 to \$538
29 million in 1961, so that they have just about
30 trebled the volume of their business.

COMMISSIONER BROWN: Would you have any

suggestions to make about increasing the permissive

rate above the \$1,000, and supplementary to that

a change in the maximum limit and also a change in

the permissive rates?

MR. MACHAMON: I shouldn't like at the

present time to make any recommendation, sir, in

I mentioned a moment ago something about

the ability of the industry to adapt itself to changed

rules, changed conditions and even more severe

limitations. Perhaps these figures might be of

interest to you. I notice that when the credit unions

were before the Commission some questions were asked

about the manner in which, or the proportions in

which the income of the credit union is spent; how

much goes for this and that purpose and this and

that expense. In the small loans field -- and

this is taking all licenses together and covers

not only the area of loans up to \$1500, but all

their business -- in 1955 the average income

expressed as a percentage of average assets during

1955, the average income was 21.4 per cent. In 1961

the ratio was 18.6 per cent. It has dropped nearly

3 per cent by reason, mainly, of course, of the

reduction in the maximum rates that they may charge.

At the same time, the average assets

have increased from \$180 million in 1955 to \$230

million in 1961, so that they have just about

tripled the volume of their business.



1 Now then, when you look at the expense side
2 you take off all items except interest on borrowed
3 money and income taxes; you take off all expenses
4 for advertising, salaries and directors' fees, all
5 other expenses except interest on borrowed money
6 and income taxes. In other words, in 1955 we found
7 that they had left 10.5 per cent from the 21.4 per cent
8 after taking off all expenses except interest on
9 borrowed money and income taxes. And that was, one
10 might say, the average rate earned on the invested
11 funds before taxes.

12 Now, in 1961 they still had 10.3 per cent
13 left. It had hardly dropped at all. The explanation,
14 of course, is that although their income dropped
15 from 21.4 per cent to 18.6 per cent, their expenses
16 had dropped, too. Their advertising is cut in half,
17 and whereas it used to be one per cent in 1955, it
18 is one-half of one per cent now and the salaries
19 and directors' fees, which were 5.2 per cent in 1955
20 are now 3.9 per cent.

21 Of course, part of the explanation also
22 lies in the much larger volume of business they are
23 doing, but I think it can fairly be said they are
24 carrying ^{on} business more efficiently now than they were
25 and they still have the same rate of earnings on the
26 invested funds; much larger funds now than as compared
27 to 1955.

28 The industry has quite a degree of adaptability.
29 Of course, it can be more selective in making its loans,
30 but we don't hear in the Department of people being



1 unable to get loans and the volume between \$1000 and
2 \$1500 is steadily increasing. This is being served,
3 to some reasonable extent anyway, by the small loans
4 licensees.

5 The industry certainly, though, has felt the
6 impact of the chartered banks, there is no question at
7 all about that, and the expansion of the credit
8 unions.

9 It is rather interesting to look at the
10 new money put out by small loans licensees at the
11 present time. In the first place, about 75 per cent
12 of new loans made each year are made to what we call
13 current borrowers, being people who already have a
14 loan with the licensee; about 75 per cent of the
15 new loans made go to these people and about two-thirds
16 of the 75 per cent -- in other words, about 50 per
17 cent of all new loans made, going to these people, are
18 used to pay off an existing balance; the current
19 borrowers, in other words, get about 25 per cent
20 of the total loans made each year. The other 25
21 per cent of the loans made each year go to brand new
22 borrowers and what we call repeat borrowers, being
23 people who had loans but had completely repaid them
24 to get in the clear but are now back.

25 COMMISSIONER BROWN:

26 To what extent has there developed a group of people
27 in the country who are always in debt?

28 MR. MacGREGOR: Well, 75 per cent of
29 the loans made every year are to people who have
30 active accounts with the lenders. In other words,



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To what extent has there developed a group of people in the country who are always in debt? MR. MACGREGOR: Well, 75 per cent of the loans made every year are to people who have active accounts with the lenders. In other words,



1 they have got their loans down to the point where
2 they are back for more.

3 COMMISSIONER LEMAN: They have built up
4 what you would call a steady business?

5 MR. MacGREGOR: It is a clientele, yes.

6 COMMISSIONER LEMAN: Might we turn now,
7 Mr. MacGregor, to the co-operative credit societies.
8 You explained to us how your jurisdiction in this
9 matter came about and it is a strange thing -- at
10 least, on the surface of it it seems a little strange --
11 you say that one of the reasons that this did come
12 about was that they themselves were a little worried
13 about their legal status due to the kind of business
14 they were doing.

15 Now, apparently therefore the Federal
16 legislator didn't decide at that time in 1952 to
17 say, "You are banks," they didn't do that, they just
18 said, "Well, you people would like to clarify your
19 status; would you like to organize some kind of
20 a supervision, or we will do it," but it was left
21 on a voluntary basis, so that the whole thing seems
22 to be a bit of a compromise. It wasn't said then
23 it is banking, but it wasn't said it is not banking;
24 it wasn't said there needs to be supervision over
25 this operation, they just said that voluntarily you
26 can subject yourself to supervision. What do you
27 think of such a development?

28 MR. MacGREGOR: Prior to 1952 we had
29 nothing to do with the credit union movement or
30 the co-operative movement except that we were then



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MR. MAGREGOR: Prior to 1932 we had

nothing to do with the credit union movement or

the co-operative movement except that we were then



1 supervising the Co-operative Life Insurance Company
2 in Saskatchewan, and about that time we were also
3 discussing with representatives of the co-operative
4 movement the incorporation of a fire and casualty
5 company that was incorporated in 1953. It was the
6 Co-operative Fire and Casualty Company in Regina.

7 I well recall those days and the discussions
8 which we had. Naturally, of course, the representatives
9 of the Co-operative Movement in Canada approached
10 the government and the Department of Finance. We
11 came into the picture subsequently.

12 Some provincial centrals -- and one in
13 particular at that time had grown to quite a substantial
14 size -- it and perhaps one or two others, but only
15 one or two others and perhaps only one other, seemingly
16 were quite concerned about their constitutional
17 position and they wanted to have it clarified.

18 Of course, for some time before that the co-operative
19 movement in Canada had been seeking federal legislation,
20 and I don't know how many times they were here.

21 I would guess two or three times before that seeking
22 federal legislation respecting central co-operative
23 credit soceties. Nothing was ever done, but late
24 in 1952 the government seemingly decided that the
25 time had arrived when something should be done,
26 and the representatives of the co-operative movement
27 and these one or two provincial centrals came and
28 were most anxious for federal legislation that
29 would legitimize -- that was the word used at the
30 time -- their operations, however appropriate it was,



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1 and they asked for supervision. They wanted it;
2 they wanted a federal act that would govern their
3 operations and would clothe them with powers to
4 accept ... deposits and make loans, that would put
5 their position beyond question. Less clear was the idea
6 of a three-tiered organization; in other words,
7 the Dominion central, I think it is correct to say,
8 was secondary. They had that, I would say, in the
9 back of their minds as something for the future but
10 it wasn't the thing that they primarily wanted at
11 that time.

12 Certainly there were no definite plans
13 as to the place the Dominion central would fill.
14 I don't think anybody knew at the time what place
15 it would fill, but the co-operative movement
16 wanted authority to set it up and get it in existence
17 and get legislation on the books that would govern
18 any such society. We sweat quite a bit of blood
19 in late 1952; we had been working in close co-operation
20 with the Department of Finance and Dr. Clarke was
21 on the scene at the time but he died suddenly, of
22 course, in December before any of this legislation
23 really was framed, and we became the successors
24 to the task of getting together a general act
25 that would be appropriate for these organizations
26 in quite a short time.

27 We did everything possible to inform
28 ourselves. Mr. Humphrys, who sits beside me,
29 visited each of the provincial centrals at
30 the time from Prince Edward Island to Vancouver to



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1 see what the situation was at first hand. We examined
2 all the provincial credit union legislation and
3 we examined similar legislation in the various
4 States, and the Act, namely, the Co-operative
5 Credit Associations Act, was the outcome.

6 It was drawn from provincial legislation
7 respecting credit unions, and we took certain State
8 provisions that we thought were good and we drew on
9 the Bank Act and the Quebec Savings Bank Act and
10 we drew on the Loan Companies Act, and so on, and
11 some were perhaps new.

12 I have read the brief of the Canadian
13 Co-operative Credit Society and the discussion,
14 and frankly I am a little disappointed at the picture
15 that has been portrayed; I think perhaps an incorrect
16 conclusion might be drawn from it or, at least,
17 one could hardly get the complete picture from
18 it.

19 The picture I got in reading the brief
20 and in reading the evidence is that the provisions
21 of this general Act have inhibited -- I think that
22 is the word they have used -- the growth of
23 the Dominion central and, rightly or wrongly, I
24 have read it all to imply that all through the years
25 from 1953 to the present the place of the Dominion
26 central -- the functions it would perform -- have
27 been well known to all those interested in it,
28 and that had it not been for certain restrictive
29 provisions in this general Act the Dominion central
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1 With all due respect, and I must say
2 that we have worked over the years in complete
3 harmony with the representatives of the centrals,
4 and I have found them most conscientious, most
5 reliable and good businessmen all through and
6 I respect them all and we have had no unpleasantness,
7 nothing of that kind at all, but in my opinion
8 nobody knew in 1952 or 1953 what place the Dominion
9 central would have, and I think it is fair to say
10 that as recently as a year ago nobody really knew
11 where it was going. If at last the co-operative
12 movement has its plans formulated in detail, I
13 think it is a very recent development.

14 In 1952 or 1953 I don't think anybody
15 on the scene then cared very much or thought very
16 much about the Dominion central at all. Some of
17 the provincial centrals were in no position to
18 join. It is mentioned in the brief -- in one of
19 the briefs -- that certain technical difficulties
20 prevented some of the provincial centrals from
21 joining the Dominion central. I know of no technical
22 difficulties except that they were not in a financial
23 position where they could possibly qualify and
24 some of them had, as far as I can ascertain, absolutely
25 no interest in the Dominion central at all at that
26 time.

27 There have been discussions --
28 we get the minutes of this organization, they are
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30 right up to a year ago anyway that indicate, I think,



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1 quite a difference of opinion amongst the several
2 provincial centrals as to whether they should get
3 on with this Dominion central or abandon it, or
4 what in the world they would do with it.

5 The fact is that the whole movement
6 of provincial centrals is fairly young, as everyone
7 knows. The credit union movement, of course,
8 is very old, but the oldest provincial central
9 goes back to 1932. I think that one of the Quebec
10 so-called centrals -- but they are different, they
11 are a different breed of central from the centrals
12 in the other provinces -- I think they go back to
13 1932, but in the other provinces there is the
14 Saskatchewan central which I think was incorporated
15 in 1941, and the British Columbia central in 1944
16 and the Ontario central in 1949 and the Manitoba
17 central in 1950.

18
19
20
21
22 (Page 6889 follows)
23
24
25
26
27
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29
30



These are the four that we supervise now, being the members of the dominion central. So that even the provincial centrals have not had a long history, by any means. Their rate of growth has varied enormously as amongst the several provinces. In Saskatchewan the rate of growth has been very fast indeed; in B.C. also; and more recently in Ontario. But apart from that, the other centrals do not seem to have attained any size yet. So the whole purpose of the dominion central was to perform a similar function at a higher level in relation to the provincial centrals that the latter now, in turn, perform for the locals. But those provincial centrals in the second tier themselves have not matured or developed to any great extent, and very few of them^{have} had any surplus funds they could deposit with the dominion central.

I think the main thing they had in mind was if any provincial central had any surplus funds to deposit and if, at the same time, some other provincial central desired to borrow, they would do it through the dominion central.

I can only say that when we dealt with this legislation in 1952 and 1953, I thought the whole idea of a dominion central at that time was premature, and I cannot help but express the view that I have felt pretty much the same way almost ever since. This is just my off-hand view, but I do not think that the position of the dominion central would be very different today from



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1 it is if there were no restrictions in the Co-op
2 Credit Associations Act at all.

3 COMMISSIONER LEMAN: But in view of
4 your knowledge of the kind of problems that exist
5 in the field, does it make sense, in general, first
6 of all, to make this on a voluntary basis and,
7 therefore, have some centrals under the Federal Act
8 and some not? Is that logical; does it make much
9 sense?

10 MR. MacGREGOR: The only logic in
11 that
12 it, as I see it, is// it is the larger ones that have
13 become concerned about their position and have voluntarily
14 joined, leaving the smaller ones that have not yet
15 attained any size unsupervised -- I should not say
16 "unsupervised", they are supervised by the province
17 of incorporation.

18 COMMISSIONER LEMAN: By the way,
19 what is the method of registration?

20 MR. MacGREGOR: It is the very same
21 as under the Bank Act. A certificate is given by
22 the Treasury Board, and it remains in force until
23 changed or withdrawn. There is not an annual
24 license or certificate granted, as we do in the case
25 of trust companies and insurance companies. The
26 procedure is the same as under the Bank Act.

27 COMMISSIONER LEMAN: I thought there
28 was some reference somewhere to the fact that
29 Parliament had something to do with it too.

30 MR. MacGREGOR: Yes. When these
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MR. MACGREGOR: Yes. When these

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1 with the corporate powers to lend, to accept deposits
2 and make loans. That meant, of course, waving a wand
3 over them in some fashion, or giving them some kind
4 of dominion status. There was ^{no} precedent, so far
5 as I know, for what was done at the time, but
6 provisions were written into this general Act
7 that these provincial centrals could become members
8 of the dominion central, and could bring themselves
9 under the general Act, if certain conditions were
10 satisfied.

11 The first condition was that
12 Parliament had declared them to be eligible to
13 become members of the dominion central. It is
14 a declaration by Parliament. So when the dominion
15 central was incorporated -- namely, the Canadian
16 Co-operative Credit Society Limited -- there was
17 a schedule in that Act setting forth the various
18 provincial centrals that were declared by Parliament
19 to be eligible to become members. At that time
20 practically all provincial centrals were named,
21 although it was pretty clear that several of them
22 were in no position where they could meet the
23 other conditions prescribed.

24 As is well known, of course, the
25 Secretary of State is prohibited, under the
26 Companies Act, from granting Letters Patent for
27 the incorporation of certain kinds of companies --
28 banks, railway companies, loan and insurance
29 companies, and so on. If persons want to get into
30 these kinds of business they must go to Parliament



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1 and get a special Act. This was the technique
2 followed to relieve these provincial centrals from
3 the necessity of coming before Parliament singly
4 and asking to be re-incorporated. Parliament declared
5 them to be eligible, and once they were declared
6 to be eligible, if they were able to meet the
7 other conditions, they could be granted these powers
8 which vested in them on a certificate being granted
9 to them by the Treasury Board pursuant to the terms
10 of the Act. It was a rather unique procedure.

11 COMMISSIONER LEMAN: It is likely
12 to remain a rather unique procedure, to treat an
13 industry on a sort of level basis, to put jurisdiction
14 on the super-super wholesale and the wholesale,
15 and nothing on the retail. That is about the
16 type of thing we have now.

17 MR. MacGREGOR: Yes.

18 I might say, one of the suggestions
19 or requests that they are making now is that any
20 other provincial centrals that have not yet joined
21 the dominion central, but who might wish to do so
22 in the future, should be relieved of the trouble
23 of coming to Parliament to be declared eligible,
24 and they ask instead that they be declared eligible
25 by Order-in-Council. I appreciate their desire
26 to avoid trouble and expense in that respect, but
27 personally I think it would be unwise to adopt
28 their suggestion. I think the whole intent in
29 requiring persons desiring to do these various
30 kinds of financial business to come to Parliament



and get a special Act. This was the technique followed to relieve these provincial councils from the necessity of coming before Parliament singly and asking to be re-incorporated. Parliament desired them to be eligible, and once they were desired to be eligible, if they were able to meet the other conditions, they could be granted these powers which vested in them on a certificate being granted to them by the Treasury Board pursuant to the terms of the Act. It was a rather unique procedure.

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MR. MACBRYEN: Yes.

I might say, one of the suggestions or requests that they are making now is that any other provincial councils that have not yet joined the dominion central, but who might wish to do so in the future, should be relieved of the trouble of coming to Parliament to be declared eligible, and they ask instead that they be declared eligible by Order-in-Council. I appreciate their desire to avoid trouble and expense in that respect, but personally I think it would be unwise to adopt their suggestion. I think the whole intent in requiring persons desiring to do these various kinds of financial business to come to Parliament



1 and get a special act, to lay their case on the
2 table and get a special act, is a desirable course;
3 and I think it should not be watered down where a
4 provincial creature desires really to attain the
5 same status but to do so by Order-in-Council.

6 I think if there is any deeming
7 to be done -- and that is what is done under this
8 Act, they are deemed to be, in effect, an association
9 incorporated by Parliament --in other words, they
10 are deemed to have the same status as though they
11 were incorporated by Parliament -- I think, if
12 any deeming is to be done for that purpose Parliament
13 ought to do it and it should not be done by
14 Order-in-Council.

15 COMMISSIONER LEMAN: If legitimizing
16 their status is the objective, and the effect is
17 that those who join are so successful in legitimizing
18 their status, they render the status of the others
19 that much more questionable, do they not? You
20 do not need to answer that question.

21 Mr. MacGregor, time passes. If
22 we stay with the present situation, there were
23 three specific requests made by the dominion central.
24 One was that they should be permitted to make loans
25 to provincial centrals up to 20 per cent of their
26 assets without security and without limits, if
27 the loan is what they call "adequately secured".
28 You say you have read their brief. Do you have
29 comments on each of these specific recommendations?

30 MR. MacGREGOR: I am happy to give



1 and get a special act, to lay their case on the
2 table and get a special act, is a desirable course;
3 and I think it should not be watered down where a
4 provincial creature desires really to attain the
5 same status but to do so by Order-in-Council.
6 I think if there is any desiring
7 to be done -- and that is what is done under this
8 Act, they are deemed to be, in effect, an association
9 incorporated by Parliament -- in other words, they
10 are deemed to have the same status as though they
11 were incorporated by Parliament -- I think, if
12 any desiring is to be done for that purpose Parliament
13 ought to do it and it should not be done by

14 COMMISSIONER LEAHY: It is legitimate
15 their status is the objective, and the effect is
16 that those who join are so successful in legitimizing
17 their status, they render the status of the others
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26 the loan is what they call "adequately secured".
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28 comments on each of these specific recommendations?
29 Mr. Macgregor: I am happy to give



1 you my views on them, yes.

2 COMMISSIONER LEMAN: That was the first
3 one.

4 MR. MacGREGOR: That was one of the
5 most troublesome points in 1952, when the Act
6 was being framed and even during its passage through
7 the committees of Parliament. At that time some
8 of the provincial centrals had individual loans
9 exceeding 10 per cent of their deposits and capital.
10 There was one loan in particular that was almost
11 frightening. It amounted to about \$1 million
12 made to a commercial co-operative in one of the
13 provinces -- not even in the province of incorporation
14 of the central, but in a neighbouring province.
15 That loan was in bad shape. It amounted then, I
16 should say, to 15 per cent of the central's deposits
17 and capital. We discussed various limiting percentages.
18 Even 10 per cent, I must say, to me at that time
19 seemed awfully large. The idea of any financial
20 organization putting 10 per cent of its assets
21 in one investment or one loan was something of
22 a shock to us. I have forgotten now whether they
23 asked for 20 per cent at that time. Perhaps they
24 did. The outcome of it was that for the dominion
25 central, which was new, the 10 per cent limit
26 was imposed, and it is in the Act today. But
27 provincial centrals, while subject to the same
28 limitations, nevertheless have another section
29 applicable to them in the Act that says they may
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go beyond 10 per cent if the loan is made to a



1 period not exceeding one year and is adequately
2 secured. That was the outcome of the argument and
3 problem that we faced at that time. Some solution
4 had to be found because there were some loans exceeding
5 10 per cent right on hand.

6 Now they ask the limit be raised to 20
7 per cent, just as you have described. When percentages
8 get up to the order of 20 per cent one might as
9 well, perhaps, better, have no percentage at all.
10 I think the idea of writing into a statute a provision
11 that a financial organization cannot put more than
12 20 per cent of its assets in one spot is inappropriate
13 really.

14 They ask for it now, of course, as I
15 understand it, mainly in reference to the dominion
16 central, because the provincial centrals may already
17 go beyond 10 per cent. Of course, they want the
18 10 per cent removed in the case of the dominion
19 central, because the dominion central has never had
20 any substantial amount of funds to lend. They feel,
21 if they are going to grow or serve any purpose,
22 that limit has to be removed. Well, of course,
23 in order to lend they have to obtain funds to
24 lend, and that brings up their second suggestion, that
25 the liquidity requirements of the provincial centrals
26 be altered so that deposits made by provincial
27 centrals with the dominion central would count
28 for the liquidity requirements of the provincial
29 centrals.

30 Perhaps before going on I might also make



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Perhaps before going on I might also make



1 this observation: It has been my understanding
2 from enquiries made at the time the Act was passed,
3 and since then, that one of the great fears of
4 people with respect to provincial central societies
5 is that they might use credit union money to make
6 loans to the commercial co-operatives. Most people
7 have not felt the centrals would lose by lending
8 to the credit unions. They fear losses by lending
9 money to the commercial co-operatives. I think
10 there is some basis for fears of that kind in
11 Belgium, Germany and so on in the years gone by.
12 I think it is one of the fears that may have kept
13 the U.S. credit unions from following the same
14 path we have followed here in creating a second
15 tier of substantial centrals. We had that background
16 from reading and talking with others in 1952 and
17 1953, but on top of that we had this case facing
18 us of a \$1 million loan of this central to a
19 commercial co-op that was then in bad shape.
20 Really, I think it is correct to say that the central
21 did not know what in the world the outcome of that
22 loan would be. It is down to about \$600,000 now,
23 but its salvation has come through the commercial
24 co-op being taken over itself by a much larger
25 co-op. So that we were fearful of losses through
26 loans being made ^{to} commercial co-ops. This is true
27 even now. As I understand it, they ask
28 that the 10 per cent rule be raised in reference
29 to loans to members of the dominion central that
30 are provincial centrals. They do not ask the 10



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1 per cent be raised in relation to the commercial
2 co-ops that are members of the dominion central.
3 I find it very difficult to deal with, because
4 from experience and one's own personal feelings,
5 it is repugnant to me to put too much money in one
6 spot. I think the 10 per cent limit is very high now.
7 At the same time, here is an organization that
8 Parliament has incorporated for a purpose; and we
9 in the department certainly do not like to be in
10 a position of appearing to hamstring this organization,
11 so it cannot even try to do what it was incorporated
12 to do -- presumably, anyway. So that while I have
13 no liking to go along with any further relaxation,
14 if the dominion central is to be given a chance to
15 perform its apparent function, it looks as though
16 some relaxation will have to be made. But if it
17 is made, I would not personally be in favour of
18 naming 20 per cent. I would rather see some -- and
19 I am reluctant to be put on record, so to speak --
20 but I think if something has to be done I would
21 prefer to see something done in reference to the
22 dominion central as was done in reference to the
23 provincial centrals in the Act. In other words,
24 there would be no specific limit stated, but
25 a provision would be included to ensure the loan
26 be of short duration, not over a year, and that
27 it be adequately secured; and thus let the dominion
28 central try to do what it claims it must do.

29 COMMISSIONER LEMAN: There is also the
30 problem of formulating the correct view in the whole



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COMMISSIONER LAMM: There is also the
problem of formulating the correct view in the whole



1 system of what the liquidity position should be
2 of the various tiers in the organization.

3 MR. MacGREGOR: Yes, indeed. That brings
4 up the second request that they have made.

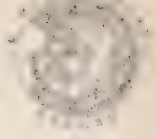
5 THE CHAIRMAN: Any further questions?

6 COMMISSIONER BROWN: Did Mr. MacGregor
7 want to say something about the second request?

8 MR. MacGREGOR: I think there are six
9 requests they have made, in fact. The first was
10 to remove the 10 per cent limit, being the maximum
11 loan that the dominion central may make to any
12 member -- to remove it at least as respects loans
13 to provincial centrals.

14 The second request they have made is
15 that the liquidity requirements applicable to the
16 provincial centrals be extended so that deposits
17 made by a provincial central with the dominion
18 central would count for the purposes of the liquidity
19 requirements, just as though it were cash or
20 dominion bonds or any of the other kinds of
21 securites that are now required to meet that
22 test.

23 A year ago, when the representatives of
24 the movement approached us, they only requested
25 that the liquidity requirements of the provincial
26 centrals be relaxed so that 5 per cent of the
27 15 per cent be permitted to be deposited with
28 the dominion central for this purpose.



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1 The rule is that at least 5 per cent of a provincial
2 central's deposits must be kept in cash. At least
3 20 per cent must be kept in the form of cash or Dominion,
4 provincial or municipal or school bonds. It
5 might all be in cash. At least 5 per cent must be
6 in cash.

7 If only 5 per cent is in cash, there is
8 15 per cent that is normally required to be in
9 government bonds or municipal or school bonds. A
10 year ago they asked that one-third of the 15 per
11 cent, namely 5 per cent, if deposited with the
12 Dominion central, would count. Now they have raised
13 that to 15 per cent.

14 In other words, if their suggestion
15 were adopted, instead of each provincial central holding,
16 say, 5 per cent of its deposits in cash and 15 per
17 cent of its deposits in government bonds and other
18 liquid securities, in its own hands, it would hold
19 only 5 per cent in cash and the other 15 per cent
20 might be deposited with the Dominion central. Well,
21 if one follows through to ascertain where are the
22 liquid resources, you find that if the Dominion
23 central, having taken these deposits, lends the
24 money, it is only required to keep 20 per cent of
25 whatever deposits the Dominion central has
26 accepted. So the 15 per cent that would normally
27 be held in liquid securities in the hands of the
28 provincial central becomes 3 per cent in the hands
29 of the Dominion central, 20 per cent of 15 per cent.

30 So that apart from getting funds in this



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1 way to lend through the dominion central, the aggregate
2 liquid resources of the whole organization are reduced
3 from 20 per cent to 8 per cent. You lose 12 per
4 cent in the process. I know that the local credit
5 unions, in most provinces, anyway. -- in some of them,
6 if not most -- are permitted to count their deposits with
7 the provincial central for the purposes of any
8 liquid test; and that is probably a good thing.

9 We can see that where resources are marshalled
10 together in one place, the organization as a whole
11 can probably get along with less than the aggregate
12 of all the individuals, if they are pooled and readily
13 available. But I do not think they can get along
14 with as little as 3 per cent instead of 15 per cent.
15 Moreover, if one looks at the actual situation the
16 problem is worse, because there is quite a disparity
17 in the relative sizes of these provincial centrals.
18 The Saskatchewan central is the largest; Manitoba
19 is very small in comparison. If their suggestion
20 were adopted, at the present time the total deposits
21 of the four provincial centrals amount to about
22 \$32 million; the deposits they have accepted from the
23 local credit unions. So apart from the 5 per cent
24 of that that the provincial centrals must hold in cash,
25 they are presently required to hold 15 per cent, or
26 about \$4,800,000, nearly \$5 million, in liquid securities.
27 Instead of the four provincial centrals holding nearly
28 \$5 million in liquid securities, if instead the
29 provincial centrals deposited these moneys with the
30 dominion central, the liquid resources held by the



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1 dominion central would be about 20 per cent of \$5
2 million, or \$1 million. You lose 80 per cent in the
3 process.

4 COMMISSIONER MACKINTOSH: Did you ever
5 have the courage to contemplate a North American and
6 then a Western Hemisphere central?

7 MR. MacGREGOR: The point that I was
8 trying to make, or get to, is that to me it seems
9 absurd that if this were done and the dominion central
10 held only \$1 million, that aggregate pool upon which
11 all the rest are dependent is less even than the
12 liquid resources that any one or two of the provincial
13 centrals should hold individually.

14 The Saskatchewan^{central} at the present time has
15 deposits of \$12 million. Its 15 per cent is \$1,800,000.
16 Surely, it would be unjustifiable to say that the
17 Saskatchewan central can forget all about that
18 \$1,800,000 and that the B.C. central, with deposits
19 of \$11 million, another \$1,700,000, should likewise
20 forget all about it so long as the dominion central,
21 for all four, holds \$1 million.

22 I would like to see the dominion central
23 succeed. We derive no pleasure in seeing an
24 organization sitting dormant when it was intended
25 to fulfil a purpose. But I really do not know what
26 moneys the provincial centrals themselves want to
27 put up with the dominion central, and even if they
28 had put it up, to whom they are going to lend it.

29 I do not think the liquidity requirements
30 themselves have been the barrier. One might jump to

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1 the conclusion that these provincial centrals in every
2 case have all their money out in loans, that they do
3 not want to invest in securities any more than they
4 can help; they do not want to meet the liquidity
5 requirements by investing in securities and then take
6 some money that they would normally lend to the local
7 credit unions and deposit it instead with the dominion
8 central. But at the present time some of these
9 centrals, and the largest ones, could make deposits
10 with the dominion central if they wanted to, so far
11 as I can see, because, take the largest, Saskatchewan,
12 it need only hold 15 per cent of \$12 million, or
13 \$1,800,000, in liquid bonds, and if it has more than
14 5 per cent cash, the \$1,800,000 is reduced to that
15 extent.

16 How many bonds has the Saskatchewan
17 central -- \$1,800,000? No. At the end of
18 1961 it had \$13 million of bonds and debentures.
19 So that, as I see it, the largest central has all
20 kinds of funds in the way of bonds now. If it
21 wanted to sell some ^{and} make a deposit with the dominion
22 central, I think it could.

23 Briefly, I could not support their request
24 to substitute deposits by the provincial central
25 with the dominion central, certainly to the extent
26 that they suggest and in the state in which the
27 dominion central presently exists. I think it is
28 one thing to marshal resources for the purposes of
29 liquidity, but usually one likes to think that in going
30 up the scale one is getting into a stronger and stronger

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1 organization. In the case of banks, you go up to the
2 Bank of Canada, and the government itself is behind even
3 that bank. But in this situation, that relationship
4 does not exist at all. You come up through the
5 provincial centrals of various degrees of strength,
6 but then you spill over into the dominion central
7 which at present is an infant, and yet these rules would
8 be designed to rely upon the dominion central as the
9 last resort.

10 COMMISSIONER LEMAN: They must feel that
11 by increasing solidity they increase effective liquidity.

12 COMMISSIONER BROWN: Part of the problem
13 is that there are so few of them. It is when you get
14 a large number of members that you can start doing this.
15 When you have only four or five members, you cannot.

16 MR. MacGREGOR: And of quite different
17 sizes. They are few, and very different in size.

18 COMMISSIONER BROWN: When you have a whole
19 50 or 60 members you can look at this a little more
20 favourably.

21 MR. MacGREGOR: If anything were done in
22 this respect at all, I think it would have to be done
23 to a very much smaller extent than they have requested.
24 I cannot, personally, see that this is the solution
25 to get funds into the dominion central. If they
26 really want to get them in, I think the provincial
27 centrals could make the deposits now, if they wanted
28 to. I only hope that if the dominion central does
29 get substantial sums of money on hand, it will not
30 put too much in one place. With all respect to the

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1 strength of commercial co-ops that are members of the
2 dominion central, I have a continuing fear, and I
3 cannot help it, that that is where the risk of loss
4 lies.

5 I must say, too, that through the piece,
6 while we have had great sympathy with the co-operative
7 people and their desire to build up this organization,
8 I have felt that the worst thing possible that could
9 happen to them would be to have this new creature get
10 into trouble early. It is bad enough to get into
11 trouble at any time, but I have felt it is in their
12 own interests that they grow and mature at a reasonable
13 pace, rather than be too impatient to have a flourishing
14 body in a very short time, because all of these develop-
15 ments, as I see it, have no precedents really, even
16 in other countries in the co-operative movement. I
17 do not know of any other country that has a three-tier
18 organization in the co-operative movement as we have
19 here now.

20 I think we all have a lot to learn. I
21 personally admit it. But I think the provincial
22 centrals and others in the co-operative movement them-
23 selves have a lot to learn. If they have not, I do
24 not know what experience they rely upon.

25 We try to keep order in our own minds in
26 dealing with these people by returning to first principles,
27 so to speak, with respect to credit unions. It does
28 seem that the main strength of a credit union lies
29 in some local body with a high degree of cohesion
30 amongst them. They know each other; they do not want to



1 strength of commercial co-ops that are members of the
2 dominion central, I have a continuing fear, and I
3 cannot help it, that that is where the risk of loss
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29 seem that the main strength of a credit union lies
30 in some local body with a high degree of cohesion
31 amongst them. They know each other; they do not want to



1 see each other lose their money; they band together
2 to make deposits, create a small pool from which they
3 will make loans, not^{to}/lend all to one person or two,
4 but to several in reasonable amounts.

5 This involves the common tie that has so
6 long been understood to be one of their main sources
7 of strength; and^{you have it}/if you deal only with members,
8 persons who are well known to each other. But it does
9 seem to me that that philosophy is being diffused
10 to some extent in the growth of these provincial
11 centrals, and now the dominion central and the link-
12 up with the commercial side of the co-operative
13 movement.

14 That brings us, of course, to some of the
15 next requests that they make. One is that they be
16 permitted to borrow other than from the central above ,
17 or the chartered banks. They ask for permission to
18 borrow in the short term money market. It seems
19 to me that is a bit of a departure from their basic
20 philosophy of dealing only with members, and I cannot
21 say that I have any enthusiasm for it. I say that
22 because, in dealing with members I suppose it might
23 reasonably be assumed that members will not go out
24 of their way to embarrass the organization. But
25 if these organizations borrow in the public, short
26 term money market, one-year notes, or whatever it may
27 be, they are going to create creditors who are not
28 members, and I am rather reluctant to see that. I
29 do not know what that may lead to, frankly.

30 The same goes, of course, on the other side,



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1 where they ask to be able to invest in short term
2 paper. At the present time they may invest up to
3 10 per cent of their deposits and capital in any
4 negotiable securities. The word "negotiable" was put
5 in there because some of the paper, if you like,
6 issued by some of the co-operative organizations
7 is not negotiable. They wanted to be in a position
8 to buy some securities within their own choice, and
9 I know they had in mind buying the bonds of some
10 co-operative organizations. Their request now stems
11 from the fact that some of their lawyers felt the
12 expression "negotiable securities" is not sufficiently
13 broad to embrace some of the short term paper that
14 they want to buy. I have no particular opposition
15 to them keeping their money at work, of course, and
16 if they want to put it out that way, and put it in
17 some I.A.C. notes, or whatever it may be, all right.
18 It does, nevertheless, put them in the position where
19 they can lend to non-members; and that, again, is
20 a variation of their basic philosophy. There is
21 not much difference in making a loan in the ordinary
22 sense and buying short term paper, or a promissory
23 note held by someone of the public who has no connection
24 with the movement at all.

25 I just wonder, really, how far the
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1 THE CHAIRMAN: Mr. MacGregor in discussing
2 the position of the centrals, the central bodies,
3 what about the advisability of extending the
4 control -- it would be federal control -- at the
5 local level? Is that impracticable, or is it
6 desirable if it were practicable?

7 MR. MacGREGOR: I suppose, sir, that
8 nothing is impossible in a way. It would be almost
9 impracticable, I think, having regard to the fact
10 that there are probably more than 4000 credit unions
11 and caisses populaires in the country. It would
12 require a tremendous ---

13 THE CHAIRMAN: On the other hand, that
14 is where a good deal of the trouble arises, is it
15 not; or might?

16 MR. MacGREGOR: There has not been too
17 much trouble ---

18 THE CHAIRMAN: There has not, perhaps,
19 been yet; but there has been tremendous growth
20 of these locals ever since the Second World War.

21 MR. MacGREGOR: Some of them are very
22 large.

23 THE CHAIRMAN: And they have never run
24 into a period of setback yet. The movement has
25 been growing and the money has been coming in.
26 Sooner or later it will level off, and then they
27 may run into difficulties. It is at the local level
28 where the difficulties of that kind might arise.

29 MR. MacGREGOR: The point you make,
30 sir, is one that we have had constantly in mind as



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10 THE CHAIRMAN: Well, of course, in
11 some provinces there is a certain amount of checking.
12 You would hardly call it supervising, because they
13 are up against the difficulty of not having enough
14 qualified people to do the auditing, or whatever
15 it is they do. At the very best, the locals
16 can only be visited once in a very long time,
17 in view of the number of them.

18 MR. MacGREGOR: From the practical
19 point of view, I think they would be best left
20 with the provincial authorities to deal with.
21 I feel something the same about the great number
22 of small mutual insurance companies that exist
23 across the country, the parish mutuals and farm
24 mutuals that just operate locally, and so on.
25 There is quite a large number of them in total,
26 although they do not add up to very much. But
27 as a practical matter, it has seemed to us to be
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30 THE CHAIRMAN: Yes, but in some places



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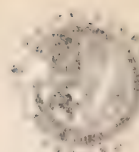
1 the local authorities do not do much at all.

2 MR. MacGREGOR: That may be so, sir.

3 THE CHAIRMAN: We are very much obliged
4 to you, Mr. MacGregor, for your assistance and
5 the full discussion we have had of the various
6 problems.

7 We shall adjourn until Monday next,
8 October 29, at 9.15 A.M., when we shall consider
9 the brief of the Canadian Federation of Mayors
10 and Municipalities.

11 --- Adjournment.



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Royal Commission on Banking and Finance

THE SUPERINTENDENT OF INSURANCE

Hearings
held at
OTTAWA

Vol.

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Date.

October 26, 1902



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Toronto, Ont.



Nethercut & Young
Toronto, Ontario

SUBMISSION

TO

THE ROYAL COMMISSION ON BANKING AND FINANCE

by

The Superintendent of Insurance

Ottawa, Canada
October, 1962



List of Acts Administered by the Federal
Department of Insurance

Department of Insurance Act (R.S.C., 1952, c. 70)

Canadian and British Insurance Companies Act
(R.S.C., 1952, c. 31; 1956, c. 28;
1957-58, c. 11; 1960-61, c. 13)

Foreign Insurance Companies Act (R.S.C., 1952, c. 125;
1956, c. 30; 1960-61, c. 16)

Loan Companies Act (R.S.C., 1952, c. 170; 1952-53, c. 5;
1958, c. 35; 1960-61, c. 51)

Trust Companies Act (R.S.C., 1952, c. 272; 1952-53, c. 10;
1958, c. 42; 1960-61, c. 55)

Small Loans Act (R.S.C., 1952, c. 251; 1956, c. 46)

Co-operative Credit Associations Act (1952-53, c. 28)

Civil Service Insurance Act (R.S.C., 1952, c. 49;
1953-54, c. 64, s. 51)

Income Tax Act (R.S.C., 1952, c. 148, as amended, s. 76)

Excise Tax Act (R.S.C., 1952, c. 100, as amended, Part I)



Summary of Companies, Societies, etc.,
Supervised

as at December 31, 1961

	<u>Canadian</u>	<u>British</u>	<u>Foreign</u>	<u>Total</u>
<u>Insurance Companies</u>				
Fire only	6	-	3	9
Fire and Casualty	79	68	111	258
Casualty only	3	8	29	40
Life only	16	5	10	31
Life and Casualty	19	-	36	55
Life, Casualty and Fire	<u>1</u>	<u>10</u>	<u>2</u>	<u>13</u>
Totals	124	91	191	406
<u>Fraternal Benefit Societies</u>				
Life only	5	-	18	23
Life, Sickness and Accident	10	-	12	22
Sickness and Accident only	<u>1</u>	<u>-</u>	<u>2</u>	<u>3</u>
Totals	16	-	32	48
<u>Loan Companies</u>				
Dominion	5	-	-	5
Provincial	<u>2</u>	<u>-</u>	<u>-</u>	<u>2</u>
Totals	7	-	-	7
<u>Trust Companies</u>				
Dominion	10	-	-	10
Provincial	<u>5</u>	<u>-</u>	<u>-</u>	<u>5</u>
Totals	15	-	-	15
<u>Licensees under Small Loans Act</u>				
Small Loans Companies	5	-	-	5
Money-lenders	<u>76</u>	<u>-</u>	<u>-</u>	<u>76</u>
Totals	81	-	-	81
<u>Central Co-operative Credit Societies</u>				
Dominion	1	-	-	1
Provincial	<u>4</u>	<u>-</u>	<u>-</u>	<u>4</u>
Totals	<u>5</u>	<u>-</u>	<u>-</u>	<u>5</u>
GRAND TOTAL				<u>562</u>

Summary of Companies, Societies, etc.,
Supervised

as at December 31, 1921

Canadian British Foreign

Life, Casualty and Fire	1	10	2
Life and Casualty	10	-	36
Life only	13	5	10
Casualty only	3	8	29
Fire and Casualty	70	60	111
Fire only	6	-	3
Totals	124	91	197
Provincial Benefit Societies			
Life, Sickness and Accident	10	-	18
Life only	5	-	38
Totals	15	-	56
Trust Companies			
Provincial	2	-	-
Domestic	5	-	-
Totals	7	-	-
Small Loan Companies			
Provincial	2	-	-
Domestic	10	-	-
Totals	12	-	-
Small Loan Societies			
Provincial	76	-	-
Domestic	5	-	-
Totals	81	-	-
Benefit Societies			
Provincial	1	-	-
Domestic	5	-	-
Totals	6	-	-



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1 Brief Summary of the Evolution of Federal
2 Insurance Legislation and Supervision

3 In order to understand the nature and extent of
4 the present functions of the Department of Insurance,
5 and the philosophy and principles underlying such
6 functions, it seems necessary to outline briefly the
7 background of Federal insurance legislation and
8 supervision. It would, of course, be impracticable
9 to deal with the many Insurance Acts that have been
10 in force from time to time in Canada or to attempt to
11 go into detail in almost any respect, but certain
12 events and features will be mentioned which, it is
13 hoped, will help to bring the present situation,
14 including the purposes of the Department, into
15 clearer focus.

16 The public has become so accustomed to government
17 supervision of insurance that perhaps few persons
18 pause to consider why this particular business came to
19 receive so much attention by the state. The main
20 reason is that insurance is a very different kind of
21 business from all other businesses. In most businesses,
22 performance of a contract is not long delayed; the
23 goods or services are usually delivered at the time
24 or soon after the consideration is paid and the
25 purchaser generally knows very well what he is getting
26 for his money. In the business of insurance, however,
27 the consideration is paid in advance and it may be
28 years - perhaps half a century or more - before the
29 insurer is called upon to perform its obligations.
30



Moreover, the services or indemnity promised may vary greatly, depending upon the contingencies insured against. The element of trust is so strong and the business is so technical that it is not surprising that many governments have been led to enact legislation designed to safeguard the policyholders' interests. In addition, it was almost inevitable that governments would be influenced by the extent to which the business might be carried on by foreign companies with head offices in distant lands.

Legislation usually follows a need and the history of our insurance legislation in Canada is no exception. All that one has to do to understand its course is to glance briefly at insurance conditions as they developed in Canada.

Early Insurers For all practical purposes it may be said In Canada. that insurance had its origin in Canada about the beginning of the nineteenth century and in the early years was carried on almost exclusively by British and foreign companies. Moreover, fire insurance was the principal class of business transacted. The first company to establish an office in Canada was the Phoenix of London in 1804. Thereafter, many British and foreign companies entered the field but there were very few Canadian companies prior to Confederation. The Fire Insurance Association of Halifax (now the Halifax Insurance Company) began as an unincorporated association in 1809. In 1829, the Quebec Fire Assurance Company was incorporated by



the Legislature of Lower Canada and in 1833 the British America Assurance Company was incorporated by the Legislature of Upper Canada. In Lower Canada in 1834 and in Upper Canada in 1836, legislation was passed providing for the incorporation of farm mutual fire insurance companies operating in counties or other restricted areas. The Western Assurance Company followed in 1851 and the County of Middlesex Mutual Fire Insurance Company (now the London-Canada Insurance Company) in 1859. The only Canadian life insurance company operating before Confederation was the Canada Life, which was incorporated in 1849. The Sun Life was incorporated in 1865, two years before Confederation, but did not begin business until 1871. The preponderance of British and foreign companies up to the time of Confederation can be seen from the fact that out of nearly 40 companies then doing business, apart from local farm mutuals, less than one-sixth were Canadian.

In 1869, the earliest year for which accurate data are available, 20 companies were licensed to transact fire insurance; 5 were Canadian companies and they wrote about 28% of the business. At the same time, 24 companies were licensed for life insurance and the one Canadian company in the field had about 15% of the total business in force. Actually, the total number of life and fire insurance companies licensed in 1869 was 39; some were licensed for both fire and life. It is interesting to observe later how the proportion of business in Canadian companies changed.



1 Although this indicates briefly the history
2 of the earliest companies operating in Canada, the
3 business developed nearly a century earlier in the
4 U.S.A. and regulatory provisions were growing up in
5 that country throughout the period just described.
6 There was uncertainty about the reliability of many
7 companies and this was greatest as respects foreign
8 companies. In 1814, the Legislature of the State
9 of New York passed a law absolutely prohibiting any
10 company resident in a foreign country from transacting
11 the business of fire insurance in that State. This
12 followed a somewhat similar law passed by Pennsylvania
13 in 1810. Since nearly all of the business in Canada
14 was being transacted by non-Canadian companies, it is
15 not unnatural that, with an eye to what was being done
16 to the south, the earliest Canadian regulatory legis-
17 lation was directed towards non-Canadian companies.

18 Pre-Confe- In 1856, New Brunswick required registration
19 deration Legislation. or licensing of fire insurance companies not
20 incorporated by the Province. A similar
21 Act was passed by the Province of Canada in
22 1860 but it went further and required a
23 deposit of \$50,000 before a licence could be obtained.
24 This legislation, applicable only to incorporated fire
25 insurance companies, was extended in 1863 to apply
26 also to societies, associations and partnerships, it
27 having evidently been found that unincorporated bodies
28 were acting as insurers. The fact that legislation
29 prior to Confederation did not apply to life insurance
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1 is not too difficult to understand; the amount of
2 business done was relatively small and the long-term
3 nature of life insurance contracts had the effect of
4 postponing the testing-time of companies.

5
6 Conditions in Canada different from Great Britain. At this point, it might be of
7 interest to comment briefly on the
8 different trend that supervision
9 on this continent took as compared
10 with that in Great Britain. Some persons may wonder
11 why Canada departed in this respect from the traditional
12 policy of freedom pursued in the Mother Country. It is
13 probably not possible to set down any precise reasons
14 that completely explain the different approach, but
15 there are one or two major circumstances that go far
16 towards such an explanation. One reason, and perhaps
17 the most important, is that insurance as we know it
18 today may be said to have had its birth and home in
19 Great Britain. The business grew and developed there
20 over a period of some 400 years (if one goes back to the
21 earliest operations of marine insurance) and was
22 carried on almost exclusively by domestic companies.
23 There were no questions or problems arising from
24 foreign companies under the direction of minds
25 thousands of miles away. Thus the circumstance that
26 gave rise to the first insurance legislation in this
27 country and in the United States - the necessity of
28 exercising some control on foreign companies - was
29 almost completely absent there. It may well be that
30 if there had been only domestic companies to deal



is not too difficult to understand; the amount of
business done was relatively small and the long-term
nature of life insurance contracts had the effect of
postponing the testing time of competition.

Conditions in the United States in this regard, it might be said
from Great Britain. In regard to economic activity on the
different level that competition
on this level took an important
with that in Great Britain. Some persons may wonder
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policy of freedom pursued in the Mother Country. It is
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almost completely absent there. It may well be that
if there had been only foreign companies to deal



1 with here in Canada, this country might have hammered
2 out a system more like that in Britain. The expression
3 "hammered out" is used advisedly, because the high
4 standard of good management and self-regulation now
5 existing in the insurance industry in Britain was
6 itself hammered out over a great many years - one
7 might almost say over some hundreds of years - as
8 will be apparent to anyone who dips, even briefly,
9 into the history of insurance and insurance regulation
10 in Britain.

11
12 Another important circumstance is that the
13 early trials of insurance companies in Great Britain,
14 the failures, the frauds, and all the things that
15 insurance legislation and supervision attempt to avoid,
16 were perhaps linked in the public and official mind
17 with the many problems arising out of the development
18 of joint stock companies, and the whole complex
19 situation as respects joint stock companies was to a
20 great extent straightened up in the 1850's and 1860's.

21 Conditions in Canada were, of course,
22 altogether different. Native companies were few and
23 generally immature; the field in Canada was occupied
24 largely by companies from out of Canada but power was
25 lacking to attach, for the protection of Canadian
26 policyholders, assets in the home lands of out-of-
27 Canada companies. It was this fact, together with
28 the failure of many companies in Britain and the U.S.A.,
29 that soon pointed to the desirability, if not necessity,
30 of government supervision.

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1 It would be wearisome to describe all of
2 the legislation since Confederation and for present
3 purposes it is unnecessary to do so. Accordingly,
4 reference will be made only to a few of the most
5 important enactments.

6
7 Post-Confe- The first Federal Insurance Act was
8 deration Legislation. assented to May 22, 1868 - less than a
9 year after Confederation and just five
10 months after the passing of the Bank Act.
11 There was thus early recognition in the new Dominion
12 of the high importance of the business of insurance.

13 Insurance The basic objectives of the Act of
14 Act, 1868. 1868 were that out-of Canada companies and
15 Dominion companies should, as a condition
16 of carrying on business in Canada, establish
17 their legal status before the Government and the public,
18 prove that they had some real substance behind them,
19 and from time to time make available to the Government
20 and to the public information concerning their
21 operations and financial condition. To secure these
22 objectives, the Act required a company to obtain a
23 licence from the Minister of Finance and to make a
24 deposit of \$50,000 for each line of insurance trans-
25 acted, except that a combination of life and accident
26 insurance, or fire and inland marine insurance,
27 required only one deposit.

28 The Act provided that it should not apply
29 to any provincially-incorporated company so long as
30



Insurance Act, 1908

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The first Federal Insurance Act was passed by the Dominion Legislature, assented to May 22, 1908 - less than a year after Confederation and just five months after the passing of the Bank Act. There was thus early recognition in the new Dominion of the high importance of the business of insurance.

The basic objectives of the Act of 1908 were that out-of-Canada companies and Dominion companies should, as a condition of carrying on business in Canada, establish their legal status before the Government and the public prove that they had some real substance behind them, and from time to time make available to the Government and to the public information concerning their operations and financial condition. To secure these objectives, the Act required a company to obtain a license from the Minister of Finance and to make a deposit of \$50,000 for each line of insurance transacted, except that a combination of life and accident insurance, or life and inland marine insurance, required only one deposit.

The Act provided that it should not apply to any provincially-incorporated company so long as



1 such company did not carry on business beyond the
2 limits of that province. Such a company might,
3 however, if it so desired, become licensed on the
4 terms applicable to other companies.

5
6 After the issuance of a licence the company
7 had to give notice of the fact in the Canada Gazette
8 and in a local newspaper but before commencing business
9 the company had to file in the Superior Court where
10 its chief agency was established a copy of its charter
11 and a power of attorney to its chief agent. The
12 company was required to file with the Minister,
13 annually, a statement of its business and also to
14 publish it in the Canada Gazette. There was, however,
15 no provision for examination by any government official.

16 One very important feature of the 1868 Act
17 should be emphasized: there was no provision for
18 an increase in deposit to correspond with an increase
19 in liabilities although it was intended that the
20 deposit of out-of-Canada companies should be increased
21 up to \$100,000 for there was a provision that such
22 companies should deposit 75% of their premium income,
23 less claims, until the deposit reached that sum.
24 Even the requirement of these nominal deposits
25 provoked much discussion and opposition on the part
26 of companies from out of Canada. Another feature,
27 which experience soon condemned, declared that any
28 British or foreign company organized on the mutual
29 principle "in such wise as to be unable legally to
30 make a deposit under the Act for the security of



1 policyholders resident in Canada" might make such
2 deposit for the general benefit of all its members,
3 but any company doing so was required to specify that
4 fact when making the deposit and in all returns made
5 or published by it. Reference will be made to both
6 of these features later.

7
8 It soon became apparent that the deposits
9 to be made with the Minister under the Act of 1868
10 were really only nominal in amount when compared with
11 the liabilities of many out-of-Canada companies to
12 their policyholders in Canada; that for business so
13 technical and with such ramifications, official
14 examination of the records and accounts of all
15 companies was necessary to give the public confidence
16 in the accuracy of their annual statements; that the
17 publication of the annual statements in the Canada
18 Gazette was not adequate to properly serve the public;
19 that the Act did not provide any tests at all of the
20 assets that a life insurance company should have to
21 enable it with certainty to meet its obligations to
22 policyholders.

23 Uneasiness was expressed in Parliament and
24 elsewhere about the danger from the operations of
25 many companies, some of which were believed to be
26 in a precarious position. For example, the following
27 statements were recorded in Hansard about that time,
28 being extracts from New York financial papers:
29
30



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"The investigation into the affairs
of . . . Life Insurance Company, which
failed in New York some months ago, shows
that there is a prospect of policyholders
receiving forty or fifty cents on the
dollar."

Another extract:

"The Attorney General of New York State,
having made application to the Supreme
Court, receivers have been appointed for
the following five companies . . ."

"An examination made previous to taking
proceedings had shown that their assets were
insufficient to reinsure their outstanding
risks. All were in business for a number of
years and exhibited in their dealings with
the assured many of the evils which have
come to light in American insurance matters
within the past four months."

Acts of 1875
and 1877.

The result was that two new Acts were
passed in 1875 and a third in 1877. It had
been the intention in 1875 to deal with all
of the matters covered by these Acts but owing to
difficulty in settling upon some of the terms to the
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1 large extent they set the pattern for subsequent
2 Federal legislation in its most significant aspects.
3 To remedy the deficiencies in the previous legislation,
4 the new Acts provided:

5 Roots of (1) That a company should maintain assets
6 Present in Canada sufficient to answer for its
7 Legisla- obligations in Canada. This had application
8 tion. more particularly to out-of-Canada companies,
9 for in the normal course the assets of
10 Canadian companies would be mainly in
11 Canada. (The out-of-Canada life insurance
12 companies strongly opposed this measure in
13 1875 and this was one of the reasons for
14 delay in passage of the legislation; but
15 the principle of full deposits to cover all
16 liabilities in Canada, which had been made
17 applicable to fire and inland marine companies
18 in 1875, was made applicable to life companies
19 too in 1877.) This has been throughout one
20 of the most important principles of our
21 legislation; it means that if an out-of-
22 Canada company should become insolvent, then
23 the assets of the company in Canada may be
24 used to reinsure its Canadian business in
25 another company in Canada.

26 (2) That a life insurance company should
27 include in the liabilities in its annual
28 statement, actuarial reserves sufficient
29 to make adequate provision for its obligations
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Canada company should become insolvent, then
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used to reimburse the Canadian business in
another company in Canada.

(2) That a life insurance company should
include in the liabilities in its annual

to make adequate provision for the largest



1 to its policyholders, but in no case less
2 than the total for which the policyholders
3 might claim if the company were insolvent.
4 Specific tables of mortality and a rate of
5 interest were prescribed for computing the
6 amount a policyholder might claim against a
7 life insurance company in insolvency. This
8 principle has been continued in the legis-
9 lation down the years, with such changes as
10 were found necessary to meet changing
11 conditions.

12 (3) That the annual statements of companies
13 should be published in a Government report
14 and thus be readily accessible to the public.

15
16 (4) That an officer to be known as the
17 Superintendent of Insurance should be
18 appointed to act under the instructions of
19 the Minister of Finance and to report to
20 him from time to time "upon all matters
21 connected with insurance as carried on by
22 the several companies licensed to do business
23 in Canada". This was the origin of the
24 Federal Department of Insurance, which
25 operated as a branch of the Department of
26 Finance until 1910 when it was constituted
27 as a separate Department but still under
28 the Minister of Finance. Among other
29 things, the Superintendent or someone
30 responsible to him was required to make an

to its policy-making, but in no case less than the total loss of the policy-making right claim in the company were involved. Specific tables of mortality and a name of interest were presented for comparing the amount of policyholders with the claim against a life insurance company in the industry. This principle has been contained in the legislation down the years, with such changes as were found necessary to meet changing

(3) That the annual statements of companies should be published in a Government report and that be readily accessible to the public

(4) That an officer to be known as the Superintendent of Insurance should be appointed to act under the instructions of the Minister of Finance and to report to him from time to time "upon all matters connected with insurance as carried on by the several companies licensed to do business in Canada". This was the origin of the Federal Department of Insurance, which operated as a branch of the Department of Finance until 1910 when it was constituted as a separate Department but still under the Minister of Finance. Among other

responsibilities to him was required to make



1 annual examination of each company at its
2 head office in Canada and to report thereon
3 to the Minister. This important duty,
4 together with the requirement of assets in
5 Canada adequate to meet the obligations of
6 companies in Canada may be regarded as two
7 of the sheet anchors in our legislation.

8
9 Government
Supervision
Questioned.

As an indication of the difference of
opinion that prevailed in those days
concerning the merits of government super-
vision, it is interesting to note a comment
made by one of the critics of the bill
introduced in 1877 to complete the original
intention of the 1875 legislation. Speaking
in the House of Commons in that year,
Dr. Tupper (afterwards Sir Charles Tupper)
used these words:

"The efforts which have been made to
obtain the greatest security for the mass
of the people depending upon life insurance,
by Government inspection, have proved in
some very important instances to be quite
abortive . . . ; . . . The circumstances
which have taken place in the State of
New York in connection with some of the
largest and most important life insurance
companies doing business on this continent,
and in Canada, have shown how utterly
hopeless it is to expect to obtain



1 security for the public through the
2 agency of Government inspection.

3 Institutions supposed to be the most
4 reliable, supposed to be the most deserv-
5 ing of public confidence, have crumbled
6 away and left vast numbers of people, who
7 have paid enormous sums of their private
8 means to those companies, without the
9 hope of securing the comfort to their
10 families, when they are obliged to leave
11 them behind, that they expected to do.

12 Those institutions have crumbled into
13 dust and caused widespread misery and
14 misfortune throughout the country. I
15 think the time has arrived when it becomes
16 the duty of the Government seriously to
17 entertain the question of giving some
18 more direct, some more absolute, certainty
19 to persons investing their money in life
20 insurance."

21 The speaker went on to suggest a system of
22 government insurance, or at least a govern-
23 ment guarantee of the obligations of insurance
24 companies. While in the foregoing one must
25 make some allowance for the fact that the
26 measure under consideration was introduced
27 by the Government of the day and the speaker
28 occupied a position on the other side, there
29 is no doubt that at that time the view which
30 he expressed was very generally held. One



1 can only speculate what the outcome would
2 have been had the Government then gone into
3 the business either directly or indirectly
4 through guaranteeing the obligations of the
5 companies. On the basis of the record of
6 the companies since then, the cost would have
7 been nil, as respects life companies, but no
8 one can say what folly might have been
9 induced by the very fact of any such
10 guarantee. Hindsight shows the wisdom of
11 the Government in avoiding the alternatives
12 suggested. Incidentally, it is of interest
13 to note that Sir Charles himself later
14 assumed the presidency of a Canadian life
15 insurance company.

16 Continuing
17 Defects in
18 Legislation.

In general, the Acts of 1875 and 1877
remedied the previous inadequate deposit
provisions but there were nevertheless two
important exceptions:

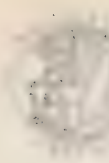
(1) The requirement of full deposits by
out-of-Canada life companies applied only
to new business and companies were permitted
to carry on the life business previously on
their books subject only to the deposit of
\$50,000 or \$100,000 already made, and

(2) The provision enabling companies
organized on the mutual plan to make their
deposits for the general benefit of all
policyholders rather than for Canadian
policyholders alone was continued.



1 With respect to (1) above, life insurance
2 companies were required by the Act of 1877
3 to maintain, in respect of business there-
4 after written, assets in Canada at least
5 equal to their total liabilities in Canada,
6 including their actuarial reserves. Business
7 written before 1878 by British and foreign
8 life companies was allowed to continue with
9 merely the nominal deposits theretofore
10 required; companies not desiring to comply
11 with the new conditions were required to
12 discontinue new business but were permitted
13 to continue their existing business subject
14 to the requirements of the legislation under
15 which it was written. Nearly one-half of
16 the British and foreign life companies then
17 licensed chose the latter course rather than
18 put up deposits to cover their liabilities.
19 Although in most cases these companies re-
20 entered the field at a later date, their
21 temporary withdrawal enabled Canadian life
22 companies to gain a foothold in the field
23 which they have since steadily maintained.

24 The fact that pre-1878 business was not
25 required to be covered fully by deposits
26 subsequently gave rise to one of the very
27 few instances where Canadian life insurance
28 policyholders of British and foreign
29 companies have suffered loss. A British
30



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the British and foreign life companies then
licensed chose the latter course rather than
put up deposits to cover their liabilities.
Altogether in most cases these companies re-
entered the field at a later date, their
companies to gain a foothold in the field
which they have since steadily maintained.
The first year 1878-1879 business was not
required to be covered fully by deposits
whereas previously it was not one of the very
few instances where Canada's life insurance
companies of British and foreign
companies have business loss. A further



1 company - the Briton Medical and General -
2 elected to discontinue new business and to
3 continue the business then on its books
4 subject to its then deposit of \$100,000.
5 The company went into liquidation with
6 liabilities to Canadian policyholders amount-
7 ing to nearly \$300,000, with the result that
8 Canadian policyholders received only small
9 payments on their equities, and were, of
10 course, left uninsured. With the passage
11 of time, the exception for pre-1878 life
12 business ceased to have any practical
13 application and was repealed in 1950.

14 There was another feature of the 1877
15 Act, referred to in (2) above, that deserves
16 special comment. In the early years, there
17 were several U.S. mutual life companies
18 operating in Canada and several stock
19 companies with the word "mutual" in their
20 names because they were transacting business
21 on the participating plan. At their
22 instance, a significant proviso was added
23 to the first Dominion Act in 1868 to the
24 effect that where a company was operating
25 on the mutual principle the \$50,000 deposit
26 should be available for the protection of
27 all policyholders and not specially for the
28 Canadian policyholders. The 1877 Act
29 retained this proviso and a prolonged debate
30



1 took place about it, very strong views being
2 expressed both pro and con. For example,
3 the following argument appears in Hansard:

4 "It would be entirely subversive of
5 the principle of mutuality and of the
6 essential and distinctive principles
7 upon which mutual companies were founded,
8 if any portion of their funds were to
9 be set aside for the exclusive benefit
10 of any portion of the insured. It
11 could not be done. It was unconstitutional.
12 It was unsound, and struck at the very
13 life and vitals of these companies."

14
15 This argument prevailed for the time and
16 the Act as passed retained the proviso in
17 question, notwithstanding a strong protest
18 from one member of Parliament that "reserves
19 in such a case will be like the fabled apples
20 of old which when grasped turn to ashes".
21 The practicability of the proviso was soon
22 to be tested. In 1877 the Atlantic Mutual
23 Life Insurance Company of the U.S. failed.
24 The Canadian deposit of \$85,000 was probably
25 sufficient, if applied solely to Canadian
26 liabilities, to reinsure the Canadian policy-
27 holders in full. The deposit had, however,
28 been made for the benefit of policyholders
29 generally, and after a long period of
30 litigation, in which the Canadian liabilities



1 gradually increased, Canadian policies were
2 cancelled, the holders receiving about 75¢
3 on the dollar as a dividend on their reserve
4 values and claims. Again, in 1879, the Globe
5 Mutual Life Insurance Company of the U.S.
6 failed. This company, while nominally mutual,
7 had a capital stock. The deposit in this
8 case was considerably in excess of Canadian
9 liabilities but when the Canadian receiver
10 proceeded to deal with it he was restrained
11 by an injunction from the U.S. receiver.
12 and only after prolonged litigation extending
13 over three or four years was he able to have
14 the deposit applied for the benefit of
15 Canadian policyholders.

16 Shadow
17 Cast on
18 Mutual
Companies.

These two experiences, together with
the experience of a number of companies not
transacting business in Canada, appear to
have shaken public confidence in mutual
companies and the proviso was deleted in
a revision of the Act in 1886. It is also
significant that in 1881 special legislation
was sought by three Canadian companies to
drop the word "Mutual" from the name in
each case. In commenting on this legis-
lation in the report on business of the
year 1882, the then Superintendent said:

"Several private Acts were passed and
it may be noted that three life insurance



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Shadow
 East on
 what



1 companies obtained Acts allowing them
2 to erase the word 'Mutual' from their
3 titles, as if this name had gained an
4 evil odour in the country."

5
6 First
Superintendent
of Insurance.

The newly-created position of Superintend-
ent of Insurance was filled on July 1,
1875, by the appointment of Professor J. B.
Cherriman, M.A., F.I.A., F.R.S.C., until
then Professor of Mathematics and Natural
Philosophy at the University of Toronto,
who evidently brought with him not only a
fine mathematical and actuarial background
but a zeal for public service and a most
conscientious fidelity to the public interest.
To him must go the credit for the foundation
of the Department and a personal influence
which was of the greatest importance to the
insurance interests of the country.

20 Anyone referring to the first memorandum
21 on life insurance legislation proposed by
22 Professor Cherriman would undoubtedly be
23 struck by the soundness of the principles
24 that he advocated. He stated that there
25 were really only two principles involved.
26 The first was "that there should be no
27 secrecy of the affairs of an insurance
28 company, that the directors are only
29 trustees or agents for the disposition of
30 the money entrusted to them by the insured,



communities I visited and following them
to secure the best results from their
efforts, as it is a well known fact
that there is no other way.

First
Superintendent
of Insurance.

The newly created position of Superintendent
of Insurance was filled on July 1

1895 by the appointment of Professor J. H.

then Professor of Mathematics and as a
philosopher at the University of Toronto,
who eventually brought with him not only a
fine mathematical and scientific background
but a zeal for public service and a more
conscientious fidelity to the public interest.
To him must go the credit for the foundation
of the Department and a personal influence
which was of the greatest importance to the
insurance interests of the country.

Anyone referring to the files maintained
on the Insurance Legislation proposed by
Professor Greenman would undoubtedly be
struck by the soundness of the principles
that he advocated. He stated that there
were really only two principles involved.
The first was that there should be no
secrecy of the affairs of an insurance
company, that the public should have only
trustees or agents for the disposition of



1 and the insured has the right to know what
2 is done with the money so entrusted". He
3 therefore urged publicity. The second
4 principle was that every company should have
5 assets in Canada sufficient to cover its
6 liabilities to policyholders in Canada. He
7 therefore urged the importance of solvency
8 and full deposits, and the legislation
9 enacted as a result of his recommendations
10 embodied these two cardinal principles. On
11 the question of investments, his recommend-
12 ations were equally sound. He said it must
13 be observed that a life company is not in
14 the position of a commercial institution
15 where a high rate of interest can be made
16 with a certain amount of risk. The all
17 essential principle of a life company is
18 security and no speculative employment of
19 the funds entrusted to it can be sanctioned.

20 Professor Cherriman remained in office
21 for ten years and retired in 1885. His
22 last official act was a warning and a
23 protest against the principle of assessment
24 insurance which was at that time beginning
25 to assert itself and to claim the right
26 to legislative recognition. On retirement
27 in 1885, Professor Cherriman was succeeded
28 in the position of Superintendent by Mr.
29 William Fitzgerald, M.A., who continued
30 until 1914. Mr. Fitzgerald was a lawyer but



is done with the money to maintain the
therefore urged that the money
principles and that every company that has
assets in Canada sufficient to cover the
liabilities to the holders of its shares, it
therefore urged the importance of delivery
and full deposits, and the full deposit
issued as a result of its research. The
expected there was a normal one in 1954. The
the question of investment and the amount
actions were equally sound. He said he was
he observed that a little company is not in
the position of a commercial institution
where a high rate of interest can be made
with a certain amount of risk. The bill
essential principle of a life company is
security and no speculative employment of
the funds entrusted to it can be substituted.
Professor Greenham remained in office
for ten years and retired in 1954. His
last official act was a warning not to
proceed against the principle of insurance
business which was at that time undergoing
to assess itself and to claim the right
to legislative recognition. On retirement
in 1954, Professor Greenham was succeeded
in the position of General Secretary by Mr.



1 also a trained mathematician, having been
2 gold medallist in mathematics under Professor
3 Cherriman at the University of Toronto.
4 Mr. Fitzgerald was in turn succeeded in
5 1914 by Mr. G. D. Finlayson, C.M.G., B.A.,
6 LL.D., A.I.A., whose ability and devotion
7 to the public interest throughout his term
8 of office until 1947 were singularly outstand-
9 ing. Mr. R. W. Warwick, M.A., A.I.A.,
10 replaced Mr. Finlayson upon the latter's
11 retirement at the end of 1947 and the present
12 incumbent succeeded Mr. Warwick upon his
13 retirement early in 1953. Thus there have
14 been only five Superintendents since the
15 first appointment in 1875; with the
16 exception of Mr. Fitzgerald, all have been
17 actuaries and with the exception of Professor
18 Cherriman each served the Department in some
19 capacity for thirty to forty years or more.

20 Reference has been made to Professor
21 Cherriman's warning and protest against the
22 principle of assessment life insurance. Had
23 his warnings been heeded, this kind of
24 business might have been curbed earlier;
25 as it was, it took nearly a generation to
26 see the last of companies and fraternal
27 benefit societies operating on this basis.
28 The episode was, it would seem, sufficiently
29 important to warrant more than passing
30 mention.



1 Insurance Legislation was enacted in 1885 with the
2 on the intention of making the public aware of the
3 Assessment nature and financial status of companies
4 Plan. transacting life insurance business on the
5 assessment plan; and perhaps also to protect
6 companies that were doing business on a sound
7 basis against competition from the assessment
8 companies. Apart from the requirement of a
9 deposit of \$50,000 precedent to the licensing
10 of any such company, the basic intent of the
11 legislation was that the public should be
12 well aware of the basis on which they carried
13 on business. To this end, every such company
14 was required to have printed in large type at
15 the head of every application, policy,
16 certificate and circular issued by it the
17 words "Assessment System"; and, in addition,
18 to have printed in a conspicuous place and
19 in prominent type, the following words:
20 "This association is not required by law to
21 maintain the reserve which is required of
22 ordinary life insurance companies". Moreover,
23 every certificate was to contain an undertaking
24 to pay the whole of the death benefit out of
25 assessments to be made for that purpose, and
26 every such company was bound by the Act to
27 make the necessary assessments; further,
28 assessments made for the payment of death
29 benefits were to be used solely for that
30 purpose and not to pay any expense whatsoever.



Insurance
on the
Assessment

Legislation was passed in 1911...
intention of ending the single...
nature and financial...
transferring life insurance...
assessment of... and perhaps also to...
companies which were doing business...
points... from the...
companies. Apart from the...
deposit of \$50,000...
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the head of every...
certificates and...
words "assessable..."
to have...
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"This... is not...
within the... which is...
every... was to...
to pay... of...
assessments to be...
every such company...
make the...
assessments made for the...
franchise was to be...



Looking back at this date, one may wonder whether the legislation may have had the effect of a warning to the public or of giving the public an unwarranted confidence in these companies. In any event, the Insurance Act of 1910 provided that a licence was not to be issued to any additional companies transacting the business of life insurance on the assessment plan. All of the companies for which the legislation had been intended had already passed from the scene. The only remaining corporations at that time operating on that basis were a few fraternal benefit societies.

Fraternal
Benefit
Societies.

Although this legislation was intended for commercial companies doing business on the assessment system and mainly for non-Canadian companies, certain fraternal benefit societies later incorporated in Canada came under such legislation as they were operating on that system and there was no other legislation to which they might have been made subject. The last of the commercial companies had disappeared by 1907, and by 1917 all of our fraternal benefit societies had reorganized and were maintaining appropriate actuarial reserves for their liabilities to members. There were, however, a large number of such societies from the United States operating in Canada under licences granted by the



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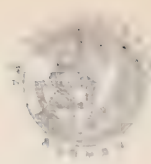
in Canada under licences granted by the

Insurance
Benefit
Societies.



1 provinces and although most of them had
2 substantial assets, they were nevertheless
3 nearly all in an unsound and insolvent
4 condition when tested according to appropriate
5 standards. It was foreign to the whole scheme
6 of legislation down to 1919 that a company
7 or society should be licensed unless it was
8 entirely sound and solvent. The practical
9 situation to be met was that these societies
10 already had considerable numbers of members
11 in Canada and it was necessary to proceed in
12 a manner that would properly safeguard the
13 interests of their members. In the circum-
14 stances, the legislation of 1919 provided that
15 any such society might be licensed if the
16 rates of contributions being charged for its
17 insurance benefits and to be charged for members
18 admitted after the date of licence were such
19 as to make reasonable provision for the benefits
20 promised to these members, but the society
21 was required to attain solvency as a whole
22 before March 31, 1925, or discontinue business
23 in Canada.

24 The effect of this legislation was
25 profound, for it required these societies
26 to become solvent as a whole or discontinue
27 business in Canada, even though in most cases
28 the proportion of the members in Canada was
29 relatively small; the reorganizations that
30



provinces and although most of them are
substantially equal, they were nevertheless
nearly all in an unimproved and unimproved
condition when started according to the
standards. It was found that the whole
of legislation down to 1919 that a company
or society should be formed unless it was
entirely honest and solvent. The position
situation to be met was that the whole
already had considerable numbers of members
in Canada and it was necessary to provide
a manner that would properly safeguard the
interests of their members. In the circumstances,
the legislation of 1919 provided that
any such society might be formed if the
rates of contributions being charged for the
insurance benefits and to be charged for the
admitted after the rate of licence were such
as to make reasonable provision for the benefit
promised to their members, but the society
was required to attain solvency as a whole
before March 31, 1920, or otherwise be
in Canada.

The effect of this legislation was
enormous, for it restricted their activities
to become solvent as a whole or otherwise
business in Canada, even though in some cases
the proportion of the members in Canada was
relatively small; the organizations that



1 these societies had to make acted like a
2 contagion throughout the whole fraternal
3 field. Dating from 1919, each fraternal
4 society licensed or registered by the
5 Department is required to have a valuation
6 made of its liabilities to members by a fully
7 qualified actuary and the actuary reports
8 in detail to the Superintendent on the
9 valuation and the investigations made by him.
10 Thus a close and effective watch is maintained
11 on the operations of these societies so that
12 it may be safe for the public to take
13 membership in them.

14 Act of
15 1899.

 An amending Act was passed in 1899 that
16 was of significance as respects investments.
17 Up to that time, the investment powers of
18 Canadian insurance companies were contained
19 in their respective Acts of incorporation
20 and such powers were by no means uniform.
21 The Act of 1899 added a new section to the
22 Insurance Act then in force which, although
23 not taking away from any company powers
24 already possessed, made their investment powers
25 otherwise uniform. This legislation provided
26 the foundation for the investment provisions
27 in all subsequent Acts and in the Insurance
28 Act of 1910 any wider powers in special Acts
29 were repealed, thus putting all Canadian
30 companies in the same position.



those reports - a list to which I have
not again referred, but which I have
filed. During the year 1900, and I think
society is now in a position to be
Department is required to have a written
case of the institution as required by the
published account and the society must
in detail of the 1900 record of the
valuation and the investment made by the
this office and the office was in a position
in the operation of these societies of the
to be in a position to be able to
make a trip to the

an account of the work done in 1900 and
of significant in respect to the
up to that time, the investment of
the 1900 investment companies were
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to all subsequent years and in the 1900
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continued in the same position



As respects the deposits required to be made by British and foreign companies, the Insurance Acts down to 1910 provided that such deposits should be in the form of Dominion or provincial government bonds or bonds of the native government of the company concerned or in such other securities as the Treasury Board might accept. The same rule applied whether the deposits were made with the Minister of Finance or with trustees. As might be expected, this latitude resulted in quite a variety of securities being tendered and accepted. Consequently, the Act of 1910 provided that British and foreign companies might thereafter vest with trustees only assets in which a Canadian company might invest and this principle has, in the main, been retained ever since.

Why Invest-

Provisions. specific investment provisions became embodied in the Insurance Act. The answer lies largely in the fact that the nature of some of the investments and collateral loans made by many companies prior to 1910 gave considerable cause for concern, as will be evident from the report of the Royal Commission on life insurance appointed in 1906. Although these early requirements had as their main object the avoidance of unduly risky investments,



1 it has been recognized throughout the years
2 that it is only by the care and experience of
3 competent officers that sound and remunerative
4 investments can be made even within the frame-
5 work of the legislative provisions.

6
7 Royal
8 Commission
9 1906.

One of the milestones in Canadian
insurance history was the appointment of the
Royal Commission on life insurance in 1906.
In 1905, an investigation had been made in
New York State into the business of life
insurance companies by a Joint Committee of
the Senate and Assembly, known as the Armstrong
Committee. The report of the Committee was
published in February, 1906. In the course
of that investigation, sensational disclosures
of most serious irregularities in the conduct
of the business appeared in the press from
day to day. The disclosures resulted in an
investigation in Great Britain by a Select
Committee of the House of Lords and were so
serious that the appointment of a Royal
Commission to inquire into the situation in
Canada was inevitable.

24
25 The Commission reported early in 1907
26 and its findings made rather disheartening
27 reading in places. The report constituted
28 a strong indictment of the management and
29 investment practices of several companies
30 and societies and recommended a completely



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and its findings were rather disappointing
meaning in places. The report contained
a strong criticism of the management and
investment practices of several companies.

Royal
1906.



1 revised Insurance Act with many new and stronger
2 features. The draft Bill so recommended was
3 altered appreciably as a result of study both
4 in and out of Parliament during the years 1907
5 to 1909 but was finally enacted as a new
6 Insurance Act in 1910.

7
8 The public exposure to which companies
9 were subjected during the inquiry induced a
10 readiness on their part to lean backwards in
11 a contrite desire to stand straight and the
12 construction placed upon the law by the
13 Department did not minimize the import of the
14 new provisions. The net effect was a resurgence
15 of circumspection concerning right principles
16 for the conduct of business which has persisted
17 to this day. At the same time, it may be
18 said that most of the substance of the Acts
19 presently in force had its roots in the Act
20 of 1910. It is difficult to summarize the
21 main objects of the 1910 legislation briefly,
22 but the leading principles were said to be
23 restriction, supervision, uniformity,
24 publicity and protection of Canadian policy-
25 holders. The need for regular and competent
26 examination into the affairs of companies and
27 the publication of full information concerning
28 any important matters respecting them was
29 manifest throughout the Commission's report.
30 In order to assist in meeting this need, the



revised Insurance Act with many new and important
features. The draft Bill so recommended was
considered especially as a result of study held
in and out of Parliament during the year 1959
to 1960 but was finally passed in a new
Insurance Act in 1960.

The public agencies to which companies
were subjected during the twenty years of
existence on that basis to their business in
a certain degree to stand original and the
contribution placed upon the law by the
Department did not minimize the impact of the
new provisions. The new effect was a result
of circumstances concerning which principles
for the conduct of business which has been
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but the leading principles were set out as

publicity and protection of consumer policy-
holders. The need for regulation and corporate
examination under the control of companies and
the publication of full information concerning

In order to assist in meeting this need, the



1 Department of Insurance was constituted in
2 1910 as a separate Department under the
3 Minister of Finance.

4 Perhaps the following excerpts from the
5 report itself may throw a good deal of light
6 upon the views of the Commission as a result
7 of their inquiry, more particularly concerning
8 the status and use of insurance funds:

9 "It seems to the Commission of importance
10 to define the nature and position of the
11 funds resulting from the operation of
12 insurance companies. Save in so far as
13 capital stock plays a part, these funds are
14 either a reserve kept in hand to discharge
15 the insurance obligation or a surplus
16 resulting from a charge upon the persons
17 insured in excess of what it has cost to
18 insure their lives. The policyholder
19 contributes both reserve and surplus, and
20 where business is done upon the participat-
21 ing plan it is the surplus moneys that are
22 called profits. How unimportant a part may
23 be played by capital stock is demonstrated
24 by an examination of the table showing the
25 capitalization of the different companies,
26 in an early part of this report. In truth,
27 when an insurance company's position has
28 become established, its capital stock
29 becomes a mere document of title by virtue
30 of which a particular body of persons



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to define the nature and position of the

funds resulting from the operation of

insurance companies. Here in so far as

capital stock plays a part, these funds are

either a reserve kept in hand to discharge

the insurance obligation of a surplus

resulting from a charge upon the surplus

incurred in excess of what it was used to

insure their lives. The policyholder

contributes both reserve and surplus, and

where surplus is due upon the policyholder

it is the surplus money that may

be paid out. Now, undoubtedly a part may

be played by capital stock in determining

by an examination of the table showing the

capitalization of the different companies,

in an early part of this report. In fact

when an insurance company's position has

become established, its capital stock

becomes a mere document of title by which



1 control those larger and more important funds
2 which the policyholders contribute. And
3 there is reason to fear a confusion of ideas,
4 with regard to his relation to these funds,
5 on the part of the person in control."

6 "And what is the character of these funds?
7 Are the purposes to which they are being
8 devoted consistent with that character?
9 Your Commissioners have no doubt that
10 accumulated insurance funds are, in every
11 essential particular, trust funds. They
12 belong to the policyholders and not to the
13 shareholders. The directors are not in
14 possession of them as trading capital in any
15 sense or to any degree. They are not subject
16 to trading risk. They are held in trust for
17 investment and to be eventually paid to those
18 whose moneys they are. Being trust funds
19 the function of the directors in regard to
20 them is the function of trustee. Once the
21 subject is put upon this simple basis the
22 criterion for determining the propriety of
23 any particular dealing by the directors with
24 these funds also becomes simple. Ought a
25 trustee to do this with trust funds? Once
26 this is recognized as the test, all difficulty
27 disappears."

28
29 "Under a former head the Commission has
30 stated very fully its conviction that all



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which the policyholders contribute. And
there is reason to fear a corruption of this
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whose money they are. Being trust funds
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them is the function of trustees. Once the
policy is put upon this simple basis the
protection for determining the propriety of
any question dealing by the directors with
these funds also becomes simple. Could a
trustee do this with trust funds? Once
this is recognized as the case, all further
difficulties."

There is to be held the foundation for



1 accumulated funds belonging to policyholders
2 are essentially trust funds. It necessarily
3 results that permissible investments should be
4 confined within such boundaries as may be
5 appropriately delimited for the investment
6 of that class of funds. Speculative invest-
7 ments ought to be excluded, and the trustee
8 directors charged with the duty of investment
9 should never be permitted to embarrass them-
10 selves by considerations arising out of any
11 personal relation on their part to the subject
12 matter of investment. In the course of this
13 inquiry the dual capacity of trustees has
14 been frequently illustrated, and many of the
15 illustrations strongly emphasize the danger
16 which is inseparable from the dual position."

17 "In respect even of the permissible range
18 of investments, many abuses have, in the
19 opinion of your Commissioners, prevailed. Your
20 Commissioners cannot believe that it was ever
21 the intention of Parliament that, under the
22 pretext of investing in the securities of
23 'public utility' corporations, insurance
24 companies should promote such companies and
25 construct and operate their works. Nor can
26 your Commissioners believe that Parliament
27 intended to sanction the acquisition by an
28 insurance company of the whole of or a
29 controlling interest in the capital stock
30 of a trust company, with the intent of



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your Commissioners believe that Parliament
intended to sanction the speculation by an
insurance company of the whole of its
capital invested in the capital stock



Nethercut & Young
Toronto, Ontario

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Page A.40 follows



Page A. 40 follows

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1 managing and operating it as a subsidiary or
2 tributary concern. These enterprises seem
3 entirely foreign to the very idea of invest-
4 ment. The insurance company is authorized
5 to invest only, and not to engage in other
6 businesses than the business of insurance.
7 The possibility of diverting insurance funds
8 from the authorized channels of investment
9 by these means could never have been in the
10 mind of Parliament when the Act was passed.
11 It may not be easy to draw the legislative
12 line, but it seems to your Commissioners
13 that, perhaps, the department may be entrusted
14 with the construction of the Act, and
15 empowered to determine in all cases whether,
16 under colour of the statutory power of
17 investing, the insurance companies are
18 embarking upon or engaging in other businesses
19 than the business of insurance."

20 Acts of
21 1917
22 et seq.

23 In 1917, a new Insurance Act was
24 passed as the result of a decision of the
25 Privy Council in 1916 relating to the
26 licensing provisions of the 1910 Act; and
27 the 1917 Act was later replaced by three
28 separate Acts in 1932 following a further
29 decision of the Privy Council in 1931
30 relating to the licensing provisions of the
1917 Act. The three new Acts in 1932 were
the Canadian and British Insurance Companies



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passed as the result of a decision of the
Privy Council in 1916 relating to the
licensing provisions of the 1910 Act; and
the 1917 Act was later replaced by the
Insurance Act of 1938 following a further
decision of the Privy Council in 1937
relating to the licensing provisions of the
1917 Act. The new Act of 1938 was
the Canadian and British Insurance Companies

Acts of
1917
of 1917.



1 Act, the Foreign Insurance Companies Act, and
2 the Department of Insurance Act, such Acts
3 being the Acts now in force.

4
5 Federal insurance legislation has been
6 revised from time to time but the essential
7 principles of safety contained in the Acts
8 of 1875 and 1877 have been substantially
9 preserved. In summary, the main purposes
10 of the legislation and of the Departmental
11 examination of companies in implementation
12 of that legislation, have been to ensure that
13 each and every company licensed or registered
14 with the Department is in a sound condition,
15 to the end that it might be safe for the
16 public to effect insurance in any such company;
17 and to give the public reason to be satisfied
18 of the likely continuance of that state of
19 affairs. In the main, these purposes have
20 been attained by requiring (1) the maintenance
21 in Canada by all out-of-Canada companies of
22 adequate assets and of records and accounts
23 of their transactions; (2) the placing of
24 sound values on the assets of all companies;
25 (3) the proper determination of the liabilities
26 of all companies; (4) the regular examination
27 of the records and accounts of companies to
28 see that these requirements are met by
29 companies on a continuing basis; and (5) the
30 publication of a detailed annual report on all
companies, giving full information for the



Now, the Foreign Insurance Companies Act, and the Department of Insurance Act, such as being the Acts now in force.

Federal Insurance legislation has been revised from time to time but the essential principles of safety contained in the Acts of 1871 and 1872 have been substantially preserved. In summary, the main purposes of the legislation and of the Department's examination of companies in implementation of that legislation, have been to ensure that each and every company licensed or registered with the Department is in a sound condition, so that it might be safe for the public to effect insurance in any such company and to give the public reason to be satisfied of the likely soundness of that state of affairs. In the main, these purposes have been attained by requiring (1) the maintenance in Canada by all out-of-Canada companies of adequate assets and of records and accounts of their transactions; (2) the placing of sound values on the assets of all companies; (3) the proper determination of the liability of all companies; (4) the regular examination of the records and accounts of companies to see that these requirements are met by companies on a continuing basis; and (5) the publication of a detailed annual report on



1 insuring public and affording a basis for
2 informed criticism within the industry itself.

3
4 Kernel of Insurance Legislation. In a nutshell, the basic principle of our
5 legislation is that the deposit system
6 for out-of-Canada companies, together with
7 publicity and inspection of all companies,
8 will secure adequate protection for the
9 public. Although criticism of the deposit
10 system is occasionally voiced by some companies,
11 none has ever been heard from policyholders.
12 In the opinion of the Department, having
13 regard for the great number and variety of
14 companies and societies operating in Canada,
15 such system is absolutely essential in Canada
16 and experience has provided ample justification
17 for it.

18 Deposit Requirements. The present deposit requirements are that
19 British and foreign companies and societies
20 must at all times maintain assets on deposit
21 with the Minister or with a trust company
22 incorporated in Canada, under an agreement
23 approved by the Minister, in an amount
24 sufficient to cover their liabilities in
25 Canada; Canadian companies and societies are
26 required to maintain only nominal deposits
27 with the Minister, but they are required to
28 hold all the remainder of their assets in
29 Canada under their own control except such
30 assets as are necessary to maintenance of any
foreign branch or branches.



insuring public and affording a basis for
 informed criticism within the industry itself.
 In a nutshell, the basic principle of the
 registration is that the deposit system
 for out-of-province companies, together with
 publicity and inspection of all companies,
 will secure adequate protection for the
 public. Although criticism of the deposit
 system is occasionally voiced by some companies,
 none has ever been heard from policyholders.
 In the opinion of the Department, having
 regard for the great number and variety of
 companies and societies operating in Canada,
 such system is absolutely essential in Canada
 and experience has provided ample justification
 for it.

The present deposit requirements are the
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 approved by the Minister, in an amount
 sufficient to cover their liabilities in
 Canada; Canadian companies and societies are
 required to maintain only nominal deposits
 with the Minister, but they are required to
 hold all the remainder of their assets in
 Canada upon their own control, though such

Deposit
 Requirements.



1	Volume of	At the end of 1961, the market value of
2	Deposits.	
3		all deposits held by the Minister or by
4		Canadian trust companies in pursuance of the
5		provisions of the Acts amounted to
6		\$2,856,107,472, subdivided as follows:
7	With the Minister of Finance	\$1,087,547,556
8	With Canadian trust companies	<u>1,768,559,916</u> \$2,856,107,472
9	Life and fraternal insurance	\$2,145,789,927
10	Fire and casualty insurance	<u>710,317,545</u> \$2,856,107,472
11	Canadian companies and	
12	societies	\$ 65,341,980
13	British companies	754,141,341
14	Foreign companies and	
15	societies	<u>2,036,624,151</u> \$2,856,107,472

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Subsidiary
Effect of
Deposit
System.

One effect of the legislation that is not apparent to the public is the exclusion from operation in Canada of the weaker non-Canadian companies which, but for the legislation, would be only too glad to come into Canada and get what business they could while they were able to remain in business. A multitude of applications have been made by such companies but when advised of the requirements the applications were not pursued. Some of these companies have then attempted to use Canadian mails and also Canadian radio stations for the solicitation of business in Canada but both of these media have been closed to such companies by action of the appropriate Dominion authorities upon the request or recommendation of the Department.



1 Investigation
2 of Complaints.

3 Apart from the foregoing, there is an
4 important function that the Department
5 performs of an extra-statutory nature.

6 It concerns complaints made by policy-
7 holders against companies or sometimes against
8 agents of companies. A considerable number of
9 complaints of this kind and inquiries of more
10 general nature concerning companies are
11 continually received. It is a most unsatis-
12 factory situation for the policyholders
13 concerned, for the particular company, and
14 in fact for the industry as a whole, if the
15 policyholder should continue to feel aggrieved,
16 whether justifiably or not; and that state of
17 mind, if not cleared up, may result in
18 unfortunate action in court. All of these
19 complaints are treated with every courtesy
20 and consideration. In each case, the facts
21 are ascertained from the company's point of
22 view, either by correspondence or by a visit
23 to the head office. With all the facts before
24 us, it is almost always possible to bring
25 about a better understanding - generally a
26 satisfactory understanding - and no case is
27 recalled where the complainant has after-
28 wards gone to court. It is correct to say
29 that practically all of the complaints arise
30 out of misunderstanding, and we believe
that the service thus afforded is most valuable
to the companies and to aggrieved policyholders.



Apart from the foregoing, there is a
 important function and the Department
 perform an extra-ordinary nature.
 In coming conditions made by policy-
 holders against companies or sometimes against
 agents of companies. A considerable number of
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 panies and nature concerning companies and
 conditions received. It is a most un-
 satisfactory situation for the policyholders
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 in fact for the industry as a whole, in the
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 and consideration. In each case, the facts
 are ascertained from the company's point of
 view, either by correspondence or by a visit
 to the head office. With all the facts before
 us, it is almost always possible to bring
 about a better understanding - generally a
 satisfactory understanding - and no case is
 notified where the complaint has a legal
 basis gone to court. It is correct to say
 that practically all of the complaints arise
 out of misunderstanding, and we believe
 that the service thus afforded is well worth



1 Change in
2 Trends.

3 During the 94 years that have elapsed
4 since the first Federal Insurance Act was
5 passed in 1868, a great change has taken
6 place in the volume of insurance in Canada
7 and in its distribution among Canadian-
8 controlled companies and other companies.
9 Fire and casualty insurance premiums which
10 in 1869 amounted to less than \$2,000,000 rose
11 to \$823,000,000 in 1961 (federally-registered
12 companies only) but the percentage written by
13 Canadian-controlled companies has decreased
14 from 28% in 1869 to 22% at the present time.
15 Moreover, of the present 22%, the personal
16 accident and sickness business of Canadian-
17 controlled life insurance companies accounts
18 for 7%, leaving 15% of the total in the
19 hands of Canadian-controlled fire and casualty
20 companies. Actually, the percentage declined
21 to only 7% in 1925 and the present 22% would
22 be about 28% if control of some of the largest
23 Canadian fire and casualty companies had not
24 been acquired in recent years by British and
25 foreign insurance companies already operating
26 in Canada. On the other hand, life insurance
27 in force, which in 1869 amounted to \$36,000,000,
28 of which 15% only was in Canadian companies,
29 had grown at the end of 1961 to \$48,000,000,000
30 (federally-registered companies only), of
which Canadian-controlled companies carried
63%. Perhaps a word by way of explanation of



1 some of the causes of the divergent trends
2 between fire and casualty business and life
3 business in purely Canadian companies might
4 be interesting. The explanation in each case
5 goes back to 1877.

6 As a result of the 1877 Act, there was a
7 temporary withdrawal of many of the largest
8 British and foreign life companies which had
9 opposed the requirement of full deposits. Of
10 30 life companies licensed at that time, 14
11 discontinued new business. During this period
12 of withdrawal (many of the withdrawing companies,
13 but not all, returned later), the Canadian
14 companies got a foot-hold which they have since
15 steadily maintained. Most of our Canadian life
16 companies came into existence during the next
17 20 years and those then in existence greatly
18 increased their strength. However, there was
19 no similar withdrawal of British and foreign
20 fire insurance companies and, in addition,
21 Canadian companies entered upon a succession
22 of serious set-backs. In 1877, there
23 occurred in St. John, N.B., what was proportion-
24 ately one of the worst conflagrations in
25 history. This conflagration brought to ruin
26 3 of the 13 Canadian licensed companies then
27 doing business and 2 others disappeared after
28 a vain struggle for existence. This disaster
29 appears to have so weakened the existing
30 companies and so discouraged capital which



1 might otherwise have sought investment in fire
2 insurance companies that the 13 companies
3 gradually decreased until in 1896 the number
4 was 5, the same as had been transacting
5 business in 1869. Further set-backs were
6 suffered by the conflagration in Ottawa in
7 1900 and in Toronto in 1904, while two of our
8 largest companies suffered severely in the
9 San Francisco conflagration in 1906. It is
10 not surprising, therefore, that the number of
11 companies doing business in 1877 was not
12 restored until more than 30 years later.

13 Middle
14 Course
15 in
16 Canada.

Our British friends, accustomed to
very little regulation, may feel that Canada
has gone further than necessary in the matter
of supervision; however, our insurance back-
ground was entirely different from theirs.
On the other hand, our American friends with
their detailed regulation may feel that we
have not gone far enough. It was probably
inevitable that Canada should have taken a
middle course in settling upon a policy
designed to achieve maximum safety for policy-
holders and yet at the same time involving
a minimum of interference with the management
of the companies. At the outset, no doubt,
there was some question in the minds of
management whether the system would prove
beneficial or otherwise. Needless to say,
all were desirous of securing some means of



1 preventing failure of insurance companies for
2 the reason that the failure of one company
3 tended to destroy the confidence of the public
4 in all the others. There was, however, fear
5 that the system might develop into an inquisi-
6 torial and vexatious interference with business
7 which would hamper the companies and through
8 a narrow view of their proper functions would
9 prevent the fullest development of the business.
10 The objections and dangers inherent in this
11 possibility have never been lost sight of by
12 the Department and policies have always been
13 framed accordingly. This is one reason for
14 not dealing with more matters in detail in
15 Federal insurance legislation but another is
16 the belief that just as the common law has
17 been said to be based on common sense, many
18 questions can be better settled on their merits
19 without the cold compulsion of legislation.
20 This may not be the easiest course in
21 supervision but within reasonable limits it
22 would seem to be the best.

23 Vindication
24 of Super-
25 vision.

23 In view of the doubts and fears
24 expressed by many critics of supervision in
25 the early years, it is natural to turn to the
26 record to appraise the effect of it in Canada.
27 The relative growth of business of all classes
28 has been enormous and has not been surpassed
29 in any other country. While it cannot be
30 claimed that this growth has been attributable



preventing failure of insurance companies in
the reason that the failure of one company
tended to destroy the confidence of the public
in all the others. There was, however, fear
that the system might develop into an insur-
torial and vesting interference with business
which would hamper the companies and through
a narrow view of their proper functions would
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This may not be the easiest course in
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In view of the facts and facts
expressed by many critics of supervision in
the early years, it is natural to turn to
record to appreciate the effect of it in time.
The relative growth of business of all kinds
has been enormous and has not been surpassed
in any other country. While it cannot be

Investigation
of Super-
vision.



wholly, or even in part, to supervision, it can at least be said that supervision has not interfered with healthy development. So far as the effect upon stability is concerned, there is probably more ground for a positive claim, more particularly when one remembers that the period under review included the two worst wars in history, pandemics, conflagrations, inflation, depression, and crises of almost every conceivable kind.

In 1869, as indicated above, there were 39 insurance companies of all kinds licensed by the Dominion. By the end of 1961, the total number was 406 (excluding 48 U.S. and Canadian fraternal benefit societies) with native origin as follows:

Australia	3
Canada	124
Denmark	4
France	7
Germany	2
Hong Kong	3
India	1
Ireland	2
Italy	1
Japan	1
Netherlands	3
New Zealand	2
Norway	1
Sweden	3
Switzerland	8
United Kingdom	81
United States	<u>160</u>
	406

During this period, however, approximately 350 other companies entered the field and withdrew or disappeared for a variety of reasons.



wholly, or even in part, to supervision, it
can at least be said that supervision has not
interfered with healthy development. So far
as the effect upon stability is concerned,
there is probably more ground for a positive
claim, more particularly when one remembers
that the period under review included the
worst years in history, panics, continental
inflation, depression, and crises of almost
every conceivable kind.

In 1889, as indicated above, there were
39 insurance companies of all kinds licensed
by the Dominion. By the end of 1921, the
total number was 406 (excluding 48 U.S. and
Canadian fraternal benefit societies) with
native origin as follows:

	Canada
	England
	Scotland
	Wales
	Ireland
	France
	Netherlands
	New Zealand
	Switzerland
8	United Kingdom
10	
10	

During this period, however, approximately
350 other companies entered the field and



Inevitably, the question arises as to the fate of their policyholders. The adequacy of the legislation dating from 1875 to protect the Canadian public is indicated by the fact that British and foreign fire and casualty insurance companies operating in Canada have in no case defaulted on their obligations to the Canadian public. Where those companies retired because of liquidation proceedings at home, Canadian deposits were used in every case to pay in full the Canadian claims for losses and unearned premiums; and in other cases their deposits were used to reinsure the Canadian business with solvent insurers. A few Canadian fire and casualty insurance companies, more particularly in the earlier years, were required to go into liquidation by reason mainly of conflagrations and in those few cases partial losses were suffered by their policyholders. In the life insurance field, with the three small exceptions already mentioned, involving one British and two United States companies where the deposit principle was not fully operative, complete protection has been provided for Canadian policyholders.

Other
Functions
of Depart-
ment.

Although the early duties of the Department related solely to the supervision of insurance companies, and this is still the main field, present functions embrace many



The latter, and question arises as to the
of their policyholders. The majority of the
institutions during from 1875 to present the
Canadian policy is indicated by the fact that
British and foreign time and casualty insurance
companies operating in Canada have in no case
been subjected to such regulations as the Canadian
policy. Where these companies received benefits
of institutions proceeded at home, Canada's
associates were used in every case to pay, in
full the Canadian claims for losses and
unrecovered premiums; and in other cases where
deposits were used to reimburse the Canadian
business with solvent insurers. A few
Canadian time and casualty insurance companies
more particularly in the earlier years, were
required to go into liquidation by reason
mainly of complications and in those rare
cases partial losses were suffered by their
policyholders. In the life insurance branch
the situation was different, involving one British and two
United States companies where the deposits
principles was not fully operative, complete
proof that has been provided for Canadian
policyholders.

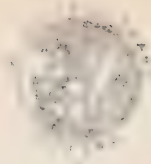
Although the early stages of this
development related closely to the requirements
of insurance companies, and this is still

of insurance companies, and this is still
at present
at present
at present



1 other fields as well. United States and
2 Dominion fraternal benefit societies registered
3 at the end of 1961 numbered 48 and their variety
4 is almost as great as their number. In 1920,
5 the Department was charged with the responsibil-
6 ity for administering the Loan Companies Act
7 and the Trust Companies Act and thus supervising
8 all Dominion loan and trust companies, of which
9 there were 5 loan companies and 10 trust
10 companies at the end of 1961; (it was incorrectly
11 stated on page 3271 of the evidence of the Trust
12 Companies Association of Canada that there are
13 only 4 Dominion, or federally-incorporated
14 trust companies); and at the request of the
15 Province of Nova Scotia in 1923, New Brunswick
16 in 1934, and Manitoba in 1938, the loan and
17 trust companies incorporated by these provinces
18 have likewise been supervised by the Department
19 since the years mentioned, but several of
20 them have merged with other companies and only
21 7 remain actively in business. The next major
22 expansion came in 1939 with the enactment of
23 the Small Loans Act. This added a field
24 which comprised 81 money-lenders at the end
25 of 1961, including both Dominion and
26 provincially-incorporated companies making
27 loans of \$1,500 or less on personal security.

28 Another more recent addition to the
29 Department's duties came with the passing of
30 the Co-operative Credit Associations Act by



other fields as well. United States and
 Dominion first-class benefit societies were
 at the end of 1901 numbered 48 and their assets
 as placed as great as their numbers. In 1900
 the Department was charged with the responsibility
 for administering the Loan Companies Act
 and the Trust Companies Act and thus supervising
 all Dominion loan and trust companies, of which
 there were 7 loan companies and 10 trust
 companies at the end of 1901 (it was later
 stated on page 3211 of the evidence of the
 Dominion Association of Canada that there were
 only 4 Dominion, or federally-incorporated
 trust companies; and at the request of the
 Province of Nova Scotia in 1923, New Brunswick
 in 1924, and Manitoba in 1926, the loan and
 trust companies have likewise been supervised by the Department
 since the years mentioned, but several of
 them have merged with other companies and
 remain actively in business. The next major
 expansion came in 1902 with the enactment of
 the Small Loans Act. This added a field
 which comprised 81 money-lenders at the end
 of 1901, including both Dominion and
 loans of \$1,500 or less on personal security
 Department's duties came with the passing of



1 Parliament in 1953. There are in Canada about
2 4,000 local credit unions (including caisses
3 populaires), all of which were incorporated
4 under provincial legislation and operate under
5 provincial supervision. In addition, most
6 provinces have incorporated a "central" credit
7 union, the members of which are local credit
8 unions in the province, and the primary
9 function of which is to accept deposits from,
10 and to make loans to, its corporate members.
11 In 1953, most of these provincial "centrals",
12 along with some other co-operatives doing an
13 interprovincial business, petitioned Parliament
14 for the incorporation of a Dominion "central"
15 to service them in much the same way as the
16 provincial "centrals" service the local credit
17 unions. The resulting legislation makes not
18 only the Dominion "central", but also such
19 provincial "centrals" as become members of it
20 (at present there are 4 of the latter), subject
21 to supervision by the Department.

22 Last to be mentioned, but by no means
23 least, is the multiplicity of actuarial and
24 related work done for the Government and for
25 other departments of the Government. This
26 work, embracing mainly pension and insurance
27 schemes of great variety and application,
28 is akin to the work performed by the Government
29 Actuary's Department in the United Kingdom and
30



Parliament in 1957. There are in Canada about
4,000 local credit unions (including co-ops)
population), all of which were incorporated
under provincial legislation and operate under
provincial supervision. In addition, most
provinces have incorporated a "central" co-op
union, the members of which are local co-op
unions in the province, and the primary
function of which is to secure financial aid
and to make loans to, its corporate members.
In 1963, most of these provincial "centrals"
along with some other co-operatives being
for the incorporation of a Dominion "central"
to service them in much the same way as the
provincial "centrals" service the local co-ops.
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provincial "central" as become members of
(at present there are 4 of the latter), and
to supervision by the Department.
least to be mentioned, but by no means
least, is the multiplicity of activities and
related work done for the Government and its
other departments of the Government. This
includes schemes of great variety and complexity,
as well as the work performed by the Government
Agency's Department in the United Kingdom.



1 some other countries. Some idea of its
2 relative extent may be gained from the fact
3 that approximately one-half of the cost of the
4 Actuarial Branch, comprising about 45 persons,
5 is attributable to this function.

6 Staff and
7 Cost of
8 Super-
9 vision.

10 All of the Department's work is
11 carried out by permanent employees, many of
12 whom have had preliminary training before
13 entering the Department and intensive
14 training in the Department in actuarial science
15 and accounting. The employment of outside
16 actuaries or examiners has never been found
17 necessary. Amongst the present total staff
18 of approximately 100 persons are 9 actuaries
19 with fellowship status, 9 with associateship
20 status, and several actuarial students. The
21 expenses of the Department, while defrayed
22 initially from a Government vote in the usual
23 way, are reimbursed by a proportionate annual
24 assessment against the companies, societies
25 and other bodies supervised (except such
26 portion of the Department's expenses as are
27 attributable to actuarial work performed for
28 other departments). As respects insurance
29 companies, the rate of assessment per \$1,000
30 of premium income in Canada has steadily
declined from 65¢ in 1940 to 42¢ in 1961,
or to about 1/25th of 1%. No licence, filing
or examination fees are imposed and no profit
results to the Government from the work of



some other countries. Some idea of the relative extent may be gained from the fact that approximately one-half of the cost of the Actuarial Branch, comprising about 45 persons is attributable to this function.

All of the Department's work is carried out by permanent employees, many of whom have had preliminary training before entering the Department and intensive training in the Department in actuarial, accounting and auditing. The employment of outside actuaries or examiners has never been found necessary. Amongst the present total staff of approximately 100 persons are 9 actuaries with fellowship status, 9 with associate status, and several actuarial students. The expenses of the Department, while derived initially from a Government vote in the usual way, are reimbursed by a proportionate amount assessed against the companies, societies and other bodies supervised (except such portion of the Department's expenses as are attributable to actuarial work performed for other departments). As respects insurance of premium income in Canada has steadily declined from \$54 in 1940 to \$24 in 1951 or to about 1/5th of 1940. No license, title or examination fees are imposed and no profit

Staff and
Cost of
Super-



1 supervision. The protection of the public,
2 rather than the reaping of a profit, has
3 remained the guiding principle of the
4 Dominion's participation in these fields from
5 the beginning up to date.

6 Jurisdiction over Insurance

7 Discussion
8 Preceding
9 Confederation.

10 The subject of insurance is not
11 mentioned in Part VI of the British North
12 America Act setting forth the distribution of
13 legislative powers between Parliament and the
14 provincial legislatures. However, it is not
15 correct to say (as has sometimes been said)
16 that this omission is explained by the
17 relative unimportance of insurance at the time
18 of Confederation or that such subject was not
19 thought of at all. An examination of the
20 minutes of the Quebec Conference in 1864 will
21 show that the Hon. Mr. Mowat moved on
22 October 25, 1864, that, among other things,
23 it should be competent for the general legis-
24 lature to pass laws respecting the following
25 matters:

- 26 1. The Indians.
- 27 2. Ferries between any province and
28 foreign country or between any two
29 provinces.
- 30 3. For the regulation and incorporation
of fire and life insurance companies.
4. Respecting Savings Banks.

31 This motion was resolved in the affirm-
32 ative but a long discussion subsequently ensued



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of Confederation or that such subject was not
brought up at all. An examination of the
minutes of the Quebec Conference in 1864 will
show that the Hon. Mr. Nowell moved on
October 25, 1864, that, among other things,
it should be competent for the general legis-
lature to pass laws respecting the following

1. The Insurances.
2. Maritime between any province and
foreign country or between any two
provinces.
3. For the regulation and improvement
of the and the insurance of the

which action was resolved in the affirmative



about the specific matters that should be allotted to the provinces, including the power to incorporate companies with local objects. The subject of insurance was not singled out in this discussion but it would appear that the existence of many county or parish mutual fire insurance companies formed under the legislation of Lower Canada in 1834 and of Upper Canada in 1836, and operating locally, may have influenced or induced the deletion of item 3 at a later stage of the Conference. However, there seems to be nothing in Pope's Confederation Documents to lend any support whatever to the view that it was ever intended to allot the incorporation, regulation and supervision of insurance companies in general to the provinces. On the contrary, it is abundantly clear that the intention was to allot to the general legislature all matters not specifically allotted to the provinces and, as respects insurance, all that seems to have been intended to be allotted to the provinces was the power to incorporate companies with purely provincial objects.

Actual
Distribution
of Powers
understood
and
accepted.

The actual distribution of powers between the Dominion and the provinces at the time of Confederation appears to have been well understood and agreed upon. Legislation enacted before Confederation dealing with purely provincial companies was allowed to



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allotted to the provinces, including the power
to incorporate companies with local objects.
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Upper Canada in 1836, and operating locally,
may have influenced or influenced the decision
of 1873 at a later stage of the Conference.
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Confederation documents to lend any support
whatever to the view that it was ever intended
to effect the incorporation, regulation and
supervision of insurance companies in general
to the provinces. On the contrary, it is
abundantly clear that the intention was to
allow to the federal legislature all matters
not specifically allotted to the provinces
and, as respects insurance, all that seems
to have been intended to be allotted to the
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Actual
Distribution
of Powers
between the Dominion and the Provinces as to
Incorporation
and
Insurance.
The actual distribution of powers
between the Dominion and the provinces as to
incorporation and insurance appears to have been
well understood and agreed upon. Legislation
created under Confederation dealing with



1 remain unrepealed by the Dominion; legislation
2 respecting alien companies was repealed and new
3 legislation respecting Dominion, British and
4 foreign companies was enacted by the Dominion.
5 The duty of supervising the incorporation and
6 operations of insurance companies operating
7 locally was logically left with the provinces.
8 Likewise, the incorporation and supervision of
9 Dominion companies and British and foreign
10 companies presumably looking to extension of
11 their business throughout the new Dominion
12 was logically placed in the hands of the
13 federal authorities. Incidentally, it might
14 here be mentioned that for nearly half a
15 century after Confederation it seems to have
16 been generally believed that a provincially-
17 incorporated company could not legally extend
18 its operations beyond the province of
19 incorporation unless empowered to do so in
20 some manner by federal authority. This point
21 was clarified by the judgment of the Privy
22 Council in the Bonanza Creek case in 1916.

23 Some
24 questions
25 arose
26 subse-
27 quently.

By reason of the fact that insurance
was not specifically mentioned in the British
North America Act, it is perhaps not surprising
that some questions subsequently arose concern-
ing jurisdiction over certain aspects of the
business. It may not, however, be generally
realized that in most cases that were taken
to the Privy Council, the origin lay not with



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legislation respecting Dominion, British and
foreign companies was enacted by the Dominion.
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was not specifically mentioned in the British
North America Act, it is deemed not appropriate
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Some
of the
cases
mentioned
in the
text



1 the respective governments but with some
2 particular kind of foreign insurer that wished
3 to do business in Canada without complying
4 with federal requirements, including deposit
5 requirements, generally applicable to all
6 companies.

7
8 The first case was in 1881 (Citizens v.
9 Parsons) where the Privy Council held that the
10 enactment of statutory conditions in fire
11 insurance policies by the Province of Ontario
12 was within the power of the province by reason
13 of its jurisdiction over property and civil
14 rights. However, at that time, there were
15 no such conditions in federal legislation and
16 there is room for doubt what the decision
17 would have been if federal legislation respect-
18 ing policy provisions had existed with regard
19 to Dominion, British and foreign companies.
20 In the later judgment of the Privy Council
21 in the Liquor Licence case in 1896, the
22 earlier decision of 1881 was referred to in
23 the following words:

24 "The scope and effect of No. 2 of
25 section 91 were discussed by this Board
26 at some length in Citizens Insurance
27 Company v. Parsons where it was decided
28 that, in the absence of legislation upon
29 the subject by the Canadian Parliament,
30 the Legislature of Ontario had authority



the respective governments but with some particular kind of foreign transfer that with to the business in Canada without complying with federal requirements, including deposit requirements, generally applicable to all

The first case was in 1881 (Citizens v. Bank) where the Privy Council held that enactment of statutory conditions in the franchise policies by the Province of Ontario was within the power of the province by reason of its jurisdiction over property and civil rights. However, at that time, there were no such conditions in federal legislation and there is room for doubt what the decision would have been if federal legislation regarding policy provisions had existed with regard to Dominion, British and foreign companies. In the later judgment of the Privy Council in the same matter case in 1898, the earlier decision of 1881 was referred to in the following words:

"The scope and effect of No. 2 of section 91 were discussed by this Board at some length in Citizens v. Bank. Gossens v. Parsons where it was decided that, in the absence of legislation upon the subject by the Canadian Parliament, the Legislature of Ontario had authority



1 to impose conditions as being matters of
2 civil right, upon the business of fire
3 insurance which was admitted to be a trade,
4 so long as those conditions only affected
5 provincial trade."

6 No. 2 of section 91 of the British North
7 America Act, referred to above, gives Parliament
8 the exclusive authority to legislate respecting
9 the regulation of trade and commerce and it is
10 to be noted that in the above decision, it was
11 admitted that insurance falls under this heading.

12 Subsequently, several cases involving the
13 licensing of foreign insurers in Canada were
14 referred to the courts and in the three cases
15 dealt with by the Privy Council in 1916, 1924
16 and 1931, it was consistently held that Parliament
17 is competent to legislate with respect thereto,
18 not only through its jurisdiction over trade
19 and commerce but also over aliens. The following
20 quotation from the decision in 1916 was reaffirmed
21 in both the 1924 and 1931 cases:

22 "The second question is, in substance,
23 whether the Dominion Parliament has
24 jurisdiction to require a foreign company
25 to take out a licence from the Dominion
26 Minister, even in a case where the
27 company desires to carry on its business
28 only within the limits of a single province.
29 To this question their Lordships' reply
30 is that in such a case it would be within

to impose conditions as being matters of civil right, upon the business of time insurance which was admitted to be a trade so long as those conditions only directly provincial trade."

Sec. 2 of section 91 of the British North America Act, referred to above, gives Parliament the exclusive authority to legislate respecting the regulation of trade and commerce and it is to be noted that in the above decision, it was admitted that insurance falls under this head.

Subsequently, several cases involving the

licensing of foreign insurance in Canada were referred to the courts and in the three cases dealt with by the Privy Council in 1916, 1924 and 1931, it was consistently held that Parliament is competent to legislate with respect thereto not only through its jurisdiction over trade and commerce but also over aliens. The following quotation from the decision in 1924 was relied in both the 1924 and 1931 cases:

"The second question is, in substance, whether the Dominion Parliament has jurisdiction to require a foreign company to take out a license from the Dominion authorities, even in a case where the company desires to carry on its business only within the limits of a single province. The question their Lordships reply



1 the power of the Parliament of Canada, by
2 properly framed legislation, to impose such
3 a restriction. It appears to them that such
4 a power is given by the heads in s. 91,
5 which refer to the regulation of trade and
6 commerce and to aliens. This question
7 also is therefore answered in the affirmative."

8 The foregoing comments relate to the
9 authority of Parliament to legislate respecting
10 alien insurers transacting business in Canada.
11 There has never been any particular doubt about
12 the authority of Parliament to incorporate and
13 regulate insurance companies of its own creation.
14 The status of such companies as compared with the
15 status of provincially-incorporated insurance
16 companies was also dealt with in the 1916
17 decision in the following terms:

18 "Where a company is incorporated to carry
19 on the business of insurance throughout
20 Canada, and desires to possess rights and
21 powers to that effect operative apart from
22 further authority, the Dominion Government
23 can incorporate it with such rights and
24 powers, to the full extent explained by
25 the decision in the case of John Deere
26 Plow Co. v. Wharton (1915, A-C., 330).
27 But if such a company seeks only provincial
28 rights and powers, and is content to trust
29 for the extension of these in other provinces
30



the power of the Parliament of Canada, by properly framed legislation, to impose such a restriction. It appears to them that a power is given by the heads in a. 31, which refer to the regulation of trade or commerce and to aliens. This question also is therefore answered in the affirmative. The foregoing comments relate to the

authority of Parliament to regulate respectively. There has never been any particular doubt about the authority of Parliament to incorporate and regulate insurance companies of its own creation. The status of such companies as compared with status of provincially-incorporated insurance companies was also dealt with in the 1910 decision in the following terms:

"Where a company is incorporated to carry on the business of insurance throughout Canada, and desires to possess rights and powers to that effect operative apart from the fact that it is a company incorporated in Canada, it can incorporate it with such rights and powers, to the full extent explained by the decision in the case of John Deere & Co. v. Wharton (1915, 40 D.L.R. 230).

But if such a company seeks only provincial rights and powers, and is content to limit for the extension of these in other provinces



1 to the Governments of those provinces, it
2 can at least derive capacity to accept such
3 rights and powers in other provinces from
4 its province of incorporation, as has been
5 explained in the case of the Bonanza Company."

6
7 Note: It is of interest and probably of
8 significance that the decision of the
9 Privy Council in the case of the Bonanza
10 Creek Gold Mining Company was rendered
11 immediately before, but at the same sitting,
12 as the decision in the Insurance Case,
13 February 24, 1916.

14 Advantage
15 in Dominion
16 incorpora-
17 tion.

14 Since the question is sometimes asked
15 whether there is any advantage in Dominion
16 incorporation as compared with provincial
17 (such question is referred to in the evidence in
18 connection with the brief of the Trust Companies
19 Association of Canada), the views of the Privy
20 Council as quoted above provide at least a
21 partial answer. The following excerpt from the
22 further judgment of the Privy Council in the
23 Great West Saddlery Co. case in 1921 also seems
24 pertinent:

25 "For the power of a province to legislate
26 for the incorporation of companies is
27 limited to companies with provincial objects,
28 and there is no express power conferred to
29 incorporate companies with powers to carry
30 on business throughout the Dominion and in



to the Government of those provinces, it
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 Great West Saddlery Co. case in 1921 also seems

for the power of a province to legislate
 for the incorporation of companies is
 limited to companies with provincial objects
 and there is no express power conferred
 upon provincial companies with powers to do



1 every province. But such a power is
2 covered by the general enabling words of
3 Section 91, which, because of the gap,
4 confer it exclusively on the Dominion. It
5 must now be taken as established that
6 Section 91 enables the Parliament of Canada
7 to incorporate companies with such status
8 and powers as to restrict the provinces
9 from interfering with the general right of
10 such companies to carry on their business,
11 where they choose, and that the effect of
12 the concluding words of Section 91 is to
13 make the exercise of this capacity of the
14 Dominion Parliament prevail in case of
15 conflict over the exercise by the provincial
16 legislatures of their capacities under the
17 enumerated heads of Section 92."

18 Thus it is clear that a Dominion company
19 possesses capacity to transact business through-
20 out Canada that is lacking, except in a condition-
21 al way in the case of a provincial company.
22 Experience also seems to demonstrate that
23 Dominion incorporation is a distinct advantage,
24 at least in the field of insurance, where a
25 company seeks to extend its operations outside
26 Canada.

27
28 Notwithstanding the authority of Parliament
29 to legislate respecting Dominion, British and
30 foreign insurance companies under the headings



every person. But even a person is
covered by the general enabling words of
Section 91, which, because of the
words "whenever" or "whenever"
must now be taken as established that
Section 91 enables the Parliament of Canada
to incorporate companies with any state
and powers as to restrict the powers
from interfering with the general right
such companies to carry on their business
where they choose, and that the effect of
the enabling words of Section 91 is to
have the exercise of this capacity of the
Dominion Parliament prevail in case of
conflict over the exercise by the provin-
cial legislatures of their capacities under
enabling words of Section 92.

There is no doubt that a Dominion company
possesses capacity to transact business through-
out Canada, except in a case
in which the case of a provincial company.
Furthermore also seems to demonstrate that
Dominion incorporation is a distinct circumstance
at least in the field of commerce, where a
company seems to extend its operations outside
the boundaries of the Dominion.

Notwithstanding the above, it is of course
impossible to say that Dominion, provincial and



1 of the regulation of trade and commerce, aliens
2 and immigration, bankruptcy and insolvency, together
3 with its possession of all residual powers not
4 specified in section 92 of the constitution,
5 including the power to incorporate companies,
6 it is at the same time clear that the provinces
7 are competent to legislate with respect to many
8 features of the business through their jurisdiction
9 over property and civil rights. Although this
10 might suggest the possibility of duplication or
11 conflict, the fact is that the existing legislation
12 of the Dominion and of the provinces is largely
13 complementary with little or no overlapping and
14 has not given rise to any serious problem in
15 recent years.

16 Present
17 situation.

The situation that has evolved in Canada
appears to be very satisfactory to all concerned.
The Federal Government is responsible for the
registration and supervision of all Dominion,
British and foreign insurance companies and
fraternal benefit societies operating in Canada,
especially from the point of view of solvency,
while the provincial governments are responsible
for provincially-incorporated companies and
societies along with legislation respecting
policy provisions, licensing of agents and
brokers, and other matters of a more local nature.
At the present time, federally registered companies
do about 95% of the life business in Canada and

of the regulation of trade and commerce, after
and immigration, bankruptcy and insolvency, in
with the possession of all residual powers not
specified in section 92 of the constitution.

It is at the same time clear that the provinces
are competent to legislate with respect to matters
over property and civil rights. Although this
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conflict, the fact is that the existing legislation
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policy provisions, licensing of agents and
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At the present time, federally regulated companies
do about 95% of the life business in Canada and



1 nearly 90% of the fire and casualty business.
2 There is complete co-operation between the federal
3 and provincial insurance departments and this has
4 resulted in uniform annual statements and other
5 uniform practices greatly to the benefit of the
6 companies and the insuring public.

7
8 Even though the existing situation is
9 presently satisfactory from the practical stand-
10 point, it would nevertheless be desirable if the
11 situation were confirmed in the British North
12 America Act. Under existing conditions, it is
13 always possible that uncertainties may arise
14 concerning the respective authority of Parliament
15 and the provincial legislatures which should be
16 avoided in the interests of all concerned. Much
17 time and money have already been spent over the
18 years in attempts to determine or clarify the
19 respective powers of the federal and provincial
20 governments in this field and it would be
21 unfortunate if this should ever happen again in
22 any substantial way. Nothing that has been said
23 above is intended to minimize or gloss over the
24 fact that the Privy Council decisions respecting
25 the business of insurance in Canada have sometimes
26 lent much support to the provincial side but at
27 the same time it must be admitted all around that
28 such decisions have sometimes also been difficult
29 to understand and have tended to confuse rather
30 than clarify the situation.



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than clarify the situation.



1 The following quotations from "Canadian
2 Constitutional Decisions of The Judicial Committee
3 of the Privy Council, 1930 to 1939" by C. P.
4 Plaxton, K.C., written while Acting Deputy
5 Minister of the Department of Justice, maybe
6 summarize the composite effect of the several
7 decisions respecting insurance as succinctly
8 as possible:

9 "The real and only point of Lord
10 Dunedin's judgment is that it forcibly
11 reaffirms and makes clear the constitutional
12 principle upon which the earlier decisions
13 of the Board really proceeded, namely,
14 that all persons, whether Canadians,
15 Britishers or foreigners, are subject in
16 the conduct of the business of insurance
17 (whether in respect of contracts or other
18 incidents of that business) to provincial
19 laws of general operation on the subject
20 of property and civil rights and that the
21 Dominion Parliament has no jurisdiction to
22 trench upon that field. It is apprehended
23 that, compatibly with Provincial control
24 over the exercise of the business of
25 insurance in relation to property and civil
26 rights, the Dominion Parliament has distinct
27 legislative authority to determine the
28 conditions upon which Dominion, foreign
29 or British companies shall be permitted
30 to transact the business of insurance in
 Canada or in any province thereof.



Department of Justice
Ottawa, Canada

A. 6

The following resolution from "Canadian
Constitutional Association of The Judicial Committee
of the Privy Council, 1930 to 1932" by C. P.
Plaxton, K.C., written while Acting Deputy
Minister of the Department of Justice, tends
to summarize the composite effect of the several
decisions respecting insurance as existing
as possible:

"The real and only point of law
in Canadian's judgment is that it is for the
purpose of making clear the constitutional
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of the Board really proceeded, namely,
that all persons, whether Canadians,
British or foreigners, are subject in
the conduct of the business of insurance
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incidents of that business) to provincial
laws of general operation on the subject
of property and civil rights and that the
Dominion Parliament has no jurisdiction
over the exercise of the business of
insurance in relation to property and civil
rights, the Dominion Parliament has dis-
legislative authority to determine the
conditions upon which Dominion, foreign
or British companies shall be permitted
to do business in the Dominion."



1 "The distinction which seems to be
2 recognized and emphasized by all the
3 decisions, including Lord Dunedin's
4 judgment, appears to be this: That there
5 is a constitutional disjunction between
6 creating or controlling or limiting the
7 subjective status and powers and the field
8 of operations of a Dominion, British or
9 foreign company incorporated for the
10 purpose of carrying on the business of
11 insurance, on the one hand, and the
12 regulation of the objective exercise of
13 its powers, in respect of property and
14 civil rights in a Province, on the other
15 hand. The former class of regulation is
16 within the exclusive competence of the
17 Dominion Parliament; the latter is within
18 the exclusive competence of the Provincial
19 legislatures."

20 As an illustration of the undesirability
21 of further conflict or confusion in the absence
22 of a clarifying amendment to the constitution,
23 perhaps the situation in the U.S.A. might be
24 referred to briefly.

25 Just as in the case of Canada, the subject
26 of insurance was not mentioned in the constitution
27 of the United States. In the United States,
28 inter-state commerce is subject to federal law
29 but the Supreme Court of the United States held
30 in about a dozen cases, beginning with Paul v.



"The distinction which seems to be
recognised and emphasised by all the
decisions, including Lord Haldane's
judgment, appears to be this: That there
is a constitutional distinction between
exercising or controlling or limiting the
subjective status and powers and the right
of operations of a Dominion, British or
foreign company incorporated for the
purpose of carrying on the business of
insurance, on the one hand, and the
regulation of the objective exercise of
its powers, in respect of property and
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referred to briefly.

Just as in the case of Canada, the subject
of insurance was not mentioned in the constitution
of the United States. In the United States,
insurance companies are subject to federal law
but the Supreme Court of the United States has



1 Virginia in 1869, that insurance is not commerce.
2 The incorporation of companies also falls generally
3 within the legislative authority of the states
4 and, unlike Canada, all residual powers rest
5 with the states. In these circumstances,
6 supervision of insurance companies rather naturally
7 grew up under the authority of the states with
8 the result that companies there operate in a very
9 complex web involving about fifty different sets
10 of state laws, insurance departments, etc.,
11 the requirements of which, although very detailed,
12 vary greatly.

13
14 There is no doubt that the situation in
15 the U.S.A. has had an effect upon the situation
16 in Canada notwithstanding the essential differences
17 between the constitutions of Canada and of the
18 U.S.A., including the essentially different
19 allocation of powers to the federal government
20 in each case. On several occasions, the United
21 States case of Paul v. Virginia and sometimes a
22 few other United States cases were cited as
23 precedents by Canadian courts and even by the
24 Privy Council. However, the Supreme Court of
25 the United States reversed its position in 1944
26 in the Southeastern Underwriters case and held
27 that insurance when conducted across state lines
28 falls under the Commerce Clause and is therefore
29 subject to the regulatory power of Congress.
30 Even the dissenting judges in the latter case
admitted that the business of insurance is



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The incorporation of companies also falls generally
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two other United States cases were cited as
precedents by Canadian courts and even by the
Privy Council. However, the Supreme Court of
the United States reversed its position in 1914
in the *Southeastern Underwriters* case and held
that insurance then constituted commerce within
this word the Commerce Clause and is therefore
subject to the regulatory power of Congress.
Even the essential factors in the latter case



1 commerce, in effect that earlier judgments were
2 wrong, but they dissented simply because reversal
3 would create turmoil in the light of the
4 elaborate system of state laws and state super-
5 vision that had evolved over a long period. As
6 a consequence of this important decision, the
7 federal government in the U.S.A. has already
8 taken several steps relating to regulation of
9 the business and great uncertainty and confusion
10 prevail as to the future. This kind of situation
11 is not in the best interests of the companies or
12 the insuring public and any risk of similar
13 confusion arising in Canada should be avoided
14 by clarification of the constitution so as to
15 confirm the existing situation in Canada.

16
17 Needless to say, what has been said above
18 concerning the constitutional aspects of
19 jurisdiction over insurance is not put forward
20 in any sense to revive controversy but simply
21 in an endeavour to outline what is believed to
22 be the true situation. There are probably only
23 a very few persons on the scene today who had
24 any close contact with past disputes in the
25 checkered history of this subject and the
26 inaccurate statements that are sometimes heard
27 indicate a rather glaring lack of familiarity
28 with its complicated background.

29 Provincial If a constitutional amendment be made to
30 Companies. confirm the status quo, the position of

commence, in effect what earlier judgments were
wrong, and they departed simply because reverse
would create turmoil in the light of the
relationship system of state laws and state super-
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a very few persons on the scene today who had
any close contact with past disputes in the
observed history of this subject and the
inaccurate statements that are sometimes heard
regarding a rather glaring lack of familiarity
with its complicated background.



1 provincially-incorporated insurance companies
2 should receive special attention. In most
3 previous recommendations to this end, it has
4 been generally agreed that the supervision of
5 provincial companies and societies operating
6 solely in their respective provinces of
7 incorporation should be left to those particular
8 provinces. This is logical and appropriate
9 having regard for the local nature of a great
10 many small companies and societies. Previous
11 recommendations have usually been framed to
12 provide also that provincial companies transact-
13 ing business in more than one province should
14 be subject to federal jurisdiction. This, too,
15 is logical and appropriate but in such cases the
16 recommendation should carry with it the necessity
17 of re-incorporation as a Dominion company or
18 society, as the case may be, and should further
19 apply where a provincial company or society
20 seeks to extend its operations outside Canada
21 even though operating in only one province.
22 There is not presently a large volume of business
23 done by provincial companies outside their
24 province of incorporation (about 1% of the total),
25 as the following data show, but the situation
26 would likely change and many new problems would
27 likely be created if registration of provincial
28 companies by the Federal Government were to
29 become a regular practice:
30



of the various special districts. It is
previously recommended to this end, it has
been generally agreed that the supervision of
provincial companies and societies operating
within the various provinces of
the Dominion should be left to those parties
concerned. This is logical and appropriate
seeing regard for the local nature of a great
number of these concerns and the fact that they
are subject to local legislation. This, too,
is logical and appropriate but in some cases
a corporation should carry with it the power
of incorporation as a Dominion company or
society, as the case may be, and should have
apply where a provincial company or society
seems to exist and operations outside the
even though operating in only one province.
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done by provincial companies outside their
provinces of incorporation (about 1% of the total
as the following table shows) but the situation
would likely change and many new problems would
likely be created in registration of provincial

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Distribution of Business in Canada among
Federally-Registered and Provincially-
Licensed Organizations

1961

Class of Company or Society	Amount of Life Insurance in Force December 31	% of Total	*Net Premiums Written during year	% of Total
	\$	%	\$	%
<u>Federally registered</u>				
Companies	48,284,483,000	93.1	823,156,846	86.5
Societies	739,493,000	1.4	-	-
Totals	49,023,976,000	(94.5)	823,156,846	(86.5)
<u>Provincially licensed only</u>				
Within province of incorporation				
Companies	2,230,465,000	4.3	81,706,486	8.6
Societies	165,259,000	.3	-	-
Outside province of incorporation				
Companies	342,627,000	.6	10,082,101	1.0
Societies	135,610,000	.3	-	-
Lloyds	-		37,337,100	3.9
Totals	2,873,961,000	(5.5)	129,125,687	(13.5)
Grand Totals	51,897,937,000	100.0	952,282,533	100.0

*Fire and casualty
insurance

If a provincial company desires to operate beyond its province of incorporation and thus act virtually as a Dominion company and at the same time seeks federal registration, it seems reasonable and right that it should be reincorporated as a Dominion company so that it will have the same



1 powers as Dominion companies generally. This has,
2 in fact, been the practice for more than thirty-
3 five years and is much the best course for all
4 concerned. Otherwise, registration of a provincial
5 company as such leaves the company in the position
6 where it can only derive its powers from the
7 province of incorporation but is subject to the
8 restrictions in both federal and provincial
9 legislation. Also, there may be doubt whether
10 some provincial companies have the capacity to
11 accept powers from another province or especially
12 from a foreign country or whether the necessary
13 powers can be conferred upon provincial companies
14 by some provinces or foreign countries. At the
15 same time, by reason of the Bonanza Creek decision
16 and subsequent provincial legislation, some
17 provincial companies in the absence of specific
18 restrictions may have all the powers of a natural
19 person, which might not be in the best interests
20 of policyholders. From the point of view of
21 supervision, it also seems better as a matter
22 of principle that the government or legislature
23 creating a company should be primarily responsible
24 for it; incorporation of a company by one govern-
25 ment in the knowledge that some other government
26 will be responsible for its operations does not
27 seem to be consistent with "responsible government".
28 Furthermore, if provincial companies could look
29 forward to registration as such by the Federal
30 Government, it would probably soon become the



1 custom to seek incorporation in whatever
2 province might have the most liberal laws and
3 some of them have been very liberal indeed.
4 In general, provincial incorporation has always
5 been obtainable more quickly and more easily
6 than Dominion incorporation; among other things,
7 the latter requires a special Act of Parliament
8 in every case whereas the former is available
9 through letters patent in many provinces.

10 As respects the operations of provincial
11 insurance companies outside Canada, such
12 operations have up to date been relatively
13 insignificant but it is a matter of regret that
14 the failure of some provincial companies has
15 done considerable damage to the cherished
16 reputation that Canadian insurance companies
17 have built up the world over. Prior to 1940,
18 a provincially-incorporated life insurance
19 company transacting business in the British
20 West Indies as well as in Canada got into
21 difficulties and loss to policyholders was
22 avoided only by the willingness of a number
23 of other Canadian companies jointly to take
24 over the assets and liabilities in order to
25 preserve the reputation of the business.
26 About the same time, another life insurance
27 company incorporated in the same province
28 but doing business in some other provinces also
29 got into difficulties and had to be taken over
30 by other companies in the same manner.



1 This experience, while it did not result in
2 any loss to policholders of the provincial
3 companies, nevertheless led the province of
4 incorporation to amend its Insurance Act soon
5 after so as to require Federal registration of
6 every life insurer in that province, regardless
7 of the manner of incorporation. In the field
8 of fire and casualty insurance, the failure two
9 years ago of a provincial company that had been
10 transacting business in the U.S.A. precipitated
11 a very large volume of complaints from United
12 States policyholders, agents, government
13 officials and other persons who naturally looked
14 upon all Canadian insurance companies alike,
15 regardless of Dominion or provincial status.
16 This case, which involved substantial losses
17 to both Canadian and United States policyholders,
18 has created a blot on the record of Canadian
19 companies operating outside Canada that may
20 take a long time to erase. Several other
21 provincial insurers have failed in recent years
22 resulting in losses to policyholders but at
23 least they were not operating outside Canada.

24 Some Practical Aspects of Supervision

25
26 The legal situation respecting jurisdiction
27 and supervision is one thing but the practical
28 means for carrying out supervision effectively
29 and economically is another thing. A well-
30 qualified staff is essential and experience has



This experience, while it did not result in any loss to policyholders of the provincial companies, nevertheless led the province to incorporation to amend its Insurance Act soon after so as to require Federal registration of every life insurer in that province, regardless of the manner of incorporation. In the field of life and casualty insurance, the failure of years ago of a provincial company that had been transacting business in the U.S.A., precipitated a very large volume of complaints from United States policyholders, agents, government officials and other persons who naturally look upon all Canadian insurance companies alike, regardless of Dominion or provincial status.

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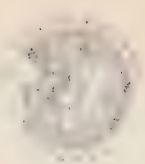
Some Federal Aspects of Supervision

The legal situation respecting jurisdiction and supervision is one thing but the practical means for carrying out supervision effectively and economically is another thing. A well-



1 demonstrated that it is impossible to recruit
2 and retain competent staff unless the work is
3 interesting and varied, is considered to be of
4 importance, and remuneration is adequate. In
5 this connection, it must be remembered that the
6 maintenance of staff, especially actuarial
7 staff, is always in competition with companies
8 in a market of continuous scarcity. The fact
9 that the Department has been singularly
10 successful in building up an excellent staff
11 of qualified actuaries when practically all
12 other insurance departments on this continent
13 have been unable to do so, is largely
14 attributable to the variety of actuarial work
15 available in the Department and to an instilled
16 desire to make the work of the Department
17 meaningful and worth while.

18 Not only do volume and variety of work
19 help to attract and retain competent staff,
20 but they also enable supervision to be
21 carried out better and more economically.
22 The existence of a competent staff of examiners,
23 who regularly visit the head offices or chief
24 places of business of all registered insurance
25 companies and fraternal benefit societies from
26 coast to coast in Canada, naturally permits other
27 kinds of companies such as loan and trust
28 companies, small loans companies and money-
29 lenders, central co-operative credit societies,
30



General view that it is impossible to recruit
and retain competent staff unless the work is
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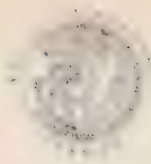


1 etc., that are likewise spread across the country,
2 to be examined at the same time as insurance
3 companies are examined. Clearly, this is
4 conducive to economy while the increased variety
5 of work tends to make examiners that much more
6 knowledgeable.

7
8 It is safe to say that the existence of a
9 competent staff of insurance examiners had much
10 to do with the extension of the Department's
11 fields of activity so as to embrace Dominion
12 loan and trust companies in 1920; and this
13 extension in turn explains in substantial
14 measure the subsequent extension of activities
15 to the other kinds of financial organizations
16 now supervised. As a purely practical matter,
17 the conclusion seems inescapable that in no
18 other way could the present work be done more
19 economically. Moreover, even if it were
20 otherwise desirable to segregate these fields
21 for supervision in some other manner, it is
22 very doubtful if competent staff could be
23 recruited and retained for that purpose alone.

24 INVESTMENTS AND DEPOSITS OF
25 INSURANCE COMPANIES

26 Although Federal insurance legislation,
27 either in special Acts or in the general Acts,
28 has from the beginning limited the investment
29 powers of Canadian insurance companies and the
30 various classes of assets that non-Canadian
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INVESTMENT AND DEPOSIT OF ASSETS

Although Federal Insurance Legislation
 either in special Acts or in the general Act
 has from the beginning limited the investment
 powers of Canadian insurance companies and the
 various classes of assets that non-Canadian



1 policyholders, there has been a constant endeavour
2 over the years to make amendments from time to
3 time to keep the investment provisions of the Acts
4 up to date. In general, however, classes have
5 not been extended or new classes added until
6 investments are seasoned by experience or are
7 otherwise obviously sound. As time went on,
8 new kinds of investments that were considered
9 to be sound came to be encountered more
10 frequently but often they differed in some
11 technical respect from the prescribed classes,
12 thus rendering them ineligible. Companies
13 transacting business out of Canada were
14 particularly prone to encounter this kind of
15 difficulty. As a result, frequent amendments
16 to the Acts became necessary. Also, new kinds
17 of investments were appearing that were very
18 difficult to describe and deal with briefly
19 in legislation.

20 "Basket"
21 Clause.

A solution was found in the enactment
of the so-called "basket" clause in 1948
whereby companies were empowered to make loans
or investments not complying with the
prescribed classes, up to 3% of a company's
ledger assets, virtually within the company's
own discretion, subject only to the retention
of a few basic limitations respecting mortgage
loans, the maximum proportion of shares held,
bonds in default, etc. The experience with
this clause proved to be quite satisfactory and



policyholders. There has been a constant effort over the years to make amendments from time to time to keep the investment provisions of the Act up to date. In general, however, classes have not been extended or new classes added until investments are seasoned by experience on the other side of the coin. As time went on, new kinds of investments that were considered to be sound came to be encountered more frequently but often they differed in some technical respect from the prescribed classes thus rendering them ineligible. Companies transacting business out of Canada were particularly prone to encounter this kind of difficulty. As a result, frequent amendments to the Act became necessary. Also, new kinds of investments were appearing that were very difficult to describe and deal with properly in legislation.

A solution was found in the enactment of the so-called "basket" clause in 1948 whereby companies were empowered to make investments in investments not complying with the prescribed classes, up to 10% of a company's ledger assets, subject to the company's own discretion, subject only to the retention of a few basic limitations respecting non-affiliates, the maximum proportion of shares held, bonds in default, etc. The experience with

Clause.



1 the maximum limit was raised in 1961 to 5%
2 of a company's total assets. At the end of
3 1961, Canadian life insurance companies as a
4 whole had \$96,298,000 invested under this
5 clause, subdivided as follows:

		% of Total Assets
Bonds	\$33,518,000	.36 of 1%
Stocks	20,041,000	.22 of 1%
Real estate	<u>42,739,000</u>	<u>.47 of 1%</u>
Total	<u>\$96,298,000</u>	<u>1.05%</u>

11 Actually, the aggregate investments made under
12 this clause have been substantially in excess
13 of the above total; many investments have
14 become eligible within the regular classes
15 subsequent to purchase and have been transferred
16 thereto; some others have, of course, been
17 sold. Since the free surplus of Canadian life
18 insurance companies amounts on the average to
19 a little more than 6% of their total assets,
20 the 5% limit on loans and investments that may
21 be made under this clause covers most of a
22 company's surplus.

23
24 In view of the existence of this clause
25 since 1948, and the fact that the latitude
26 thereunder is far from being exceeded, it is
27 rather surprising to hear criticism voiced
28 occasionally by certain segments of the public
29 that the investment provisions of the Insurance
30 Acts are too stringent; that, in particular,



the maximum limit was raised in 1961 to 25% of a company's total assets. At the end of 1961, Canadian life insurance companies as a whole had \$96,298,000 invested under this clause, subdivided as follows:

% of Total Assets		
Bonds	\$35,518,000	36.98
Stocks	20,041,000	20.91
Real estate	18,739,000	19.46
Total	\$96,298,000	100.00

Actually, the aggregate investments made under this clause have been substantially in excess of the above total; many investments have become eligible within the regular classes subsequent to purchase and have been transferred thereto; some others have, of course, been sold. Since the free surplus of Canadian life insurance companies amounts on the average to a little more than 6% of their total assets, the 25% limit on loans and investments that may be made under this clause covers most of a company's surplus.

In view of the existence of this clause since 1945, and the fact that the limit thereunder is far from being exceeded, it is rather surprising to hear officials claim occasionally by certain segments of the public that the investment provisions of the Insurance Act are antiquated.



the 7-year dividend record for common stocks prevents insurance companies from purchasing many shares alleged to be desirable investments; that the companies are prevented from investing in new enterprise, etc. The fact is that the Acts do not seriously hamper companies in any of these respects. The companies in the main are free to purchase any bonds that are not in default or any shares of stock regardless of their dividend record, up to a total of 5% of their assets; at present the total amounts to little more than 1%, so criticism of the kind referred to can only be set down as uninformed.

Invest-
ment
Trends.

Sometimes, public criticism is also heard to the effect that companies have not been sufficiently responsive to the national interest, especially in reference to investments in common stocks and the retention of control of Canadian industry in Canadian hands. The following table indicates in very brief form the trends in the investments of Canadian life insurance companies during the past thirty years:

Note: The percentages for common stocks held from 1930 to 1940 were affected greatly by the very large proportion of one company's assets in common stocks during that period. For example, in 1930 the proportion for that particular company was 50.5% while for all other companies it was only 1.6%



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 any shares alleged to be desirable investments;
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 their assets; at present the total amount is
 little more than 25%, no criticism of the kind
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Invest-
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 Trends.



As will be seen, the proportion in government bonds rose sharply during the last war to a high point of 57% at the end of 1945; this was completely in harmony with the national interest. After the war, the companies naturally tended to shift their funds more toward municipal bonds first, yielding a higher return, then toward corporation bonds and then toward real estate mortgages. The proportion in government bonds has declined to 16.0% but the proportion in mortgages has increased from 7.7% at the end of 1945 to 37.0% at the end of 1961 and this was clearly in harmony with public demand for more mortgage money.

Common
Stocks.

It is true that the porportion in common stocks has remained relatively low at about 4% for many years and various comments have been heard in regard thereto from time to time. Some comments imply that the companies have not done their duty by not investing more heavily in stocks, even to the point of acquiring enough to keep control of various industries in Canada. But funds that have been lent on real estate mortgages or otherwise invested cannot be used to purchase stocks as well. If the companies had purchased more stocks, there would have been that much less available for mortgages and other forms of investment. Moreover, it has generally been regarded as against the public interest for



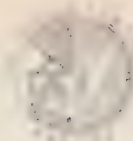
As will be seen, the proportion in government bonds rose sharply during the last war to a high point of 57% at the end of 1915; this was completely in harmony with the national interest. After the war, the companies naturally tended to shift their funds more toward municipal bonds first, yielding a higher return, then toward corporation bonds, and then toward real estate mortgages. The proportion in government bonds has declined to 15.4% but the proportion in mortgages has increased from 7.7% at the end of 1915 to 27.3% at the end of 1931 and this was clearly in harmony with public demand for more

It is true that the proportion in common stocks has remained relatively low at about 1% for many years and various comments have been heard in regard thereto from time to time. Some comments imply that the companies have not done their duty by not investing more heavily in stocks, even to the point of acquiring enough to keep control of various industries in Canada. But funds that have been lent on real estate mortgages or otherwise invested cannot be used to purchase stocks as well. If the companies had purchased more stocks, there would have been that much less available for mortgages and other forms of investment. Moreover, it has generally been regarded as against the public interest to

Common
Stocks



1 large financial institutions to control other
2 industries in the country and it is difficult
3 not to think that there would have been very
4 serious public criticism if Canadian life
5 insurance companies had embarked upon that course.
6 The main purpose of the T.N.E.C. investigation
7 in the U.S.A. some years ago was to avoid anything
8 of this nature. Another fundamental aspect is
9 whether stocks of the right quality and investment
10 yield are available in Canada in sufficient quantity
11 to make any large scale investment therein possible
12 even if it were otherwise desirable. The yields
13 available on Canadian stocks at prices prevail-
14 ing in recent years have been very low and it
15 would seem that U.S. stocks have had greater
16 attraction since the present proportion of 4.0%
17 comprises 1.3% Canadian stocks, 2.0% U.S. and
18 .7% other (mainly U.K.) stocks. Further, many
19 life insurance companies do not feel that common
20 stocks are a suitable investment medium for life
21 insurance funds and one of the very largest U.S.
22 life companies is strongly against the investment
23 of any life funds in that way. Certainly, if
24 a life company does invest heavily in common
25 stocks, it exposes itself to the wide fluctuations
26 of the market and if it should suffer embarrassment
27 as a consequence, the criticism of policyholders
28 would inevitably be loud, sharp and prolonged.
29 It is impossible to satisfy all critics and the
30 first duty of life companies is to their policy-



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1 holders. Incidentally, it might properly be
2 suggested that those life companies that are in
3 the process of mutualization have made a very
4 substantial investment toward retaining Canadian
5 control of some very important companies.

6
7 So far as the Department is concerned, the
8 investment provisions of the Insurance Acts seem
9 to be generally satisfactory, being sufficiently
10 broad not to impede the flow of capital funds
11 for almost all legitimate purposes and at the
12 same time to afford ample scope for different
13 investment policies, yet circumscribed by enough
14 safeguards to keep investments generally within
15 safe and proper bounds.

16 **15% Limit**
17 **on Common**

17 **Stocks.** continually seems to attract attention and that
18 is the 15% limit on common stocks; sometimes also,
19 the requirement that stocks must be taken at their
20 market values for annual statement purposes,
21 comes in for some criticism by the companies.
22 As mentioned in the brief of the Canadian Life
23 Insurance Officers Association, at the time of
24 the last revision of the Acts in 1961 the
25 companies recommended that the existing limit
26 of 15% be raised to 25% of total assets and that
27 stocks be valued at the average of the three most
28 recent year-end market values, but the Department
29 did not support either of these recommendations.
30 In this connection, it is sometimes suggested or



holders. Incidentally, it might properly be suggested that those life companies which are in the process of mutualization have made a very substantial investment toward retaining Canadian control of some very important companies.

So far as the Government is concerned, the investment operations of the Insurance Act are to be generally satisfactory, being sufficiently broad not to ignore the flow of capital funds for almost all legitimate purposes and at the same time to afford some scope for different investment policies, as circumscribed by enough safeguards to keep investments generally within safe and proper bounds.

There is one provision, however, that continually seems to attract attention and that is the 1% limit on common stocks; sometimes with the requirement that stocks must be rated at least market values for annual statement purposes. There is for some confusion by the Commission as mentioned in the brief of the Canadian Life Insurance Officers Association at the time of the last revision of the Act in 1971. The Commission recommended that the existing limit of 5% be raised to 25% on total assets and that stocks be valued at the average of the three most recent year-end market values, and the Department had not suggested either of these recommendations.



1 implied that if it were not for the existing 15%
2 limit and market value basis of valuation,
3 companies might invest more of their funds in
4 common stocks.

5
6 Perhaps it would be interesting to mention
7 the origin of the present 15% limit.

8 Prior to 1932, there was no limit in the
9 Insurance Act on the proportion of its assets
10 that an insurance company might invest in
11 common stocks. However, in his report for 1928
12 the then Superintendent of Insurance recommended
13 that there be considered a statutory limitation
14 on the proportion of the assets of any company
15 that might be so invested. The following is an
16 extract from that report:

17 "It has been the aim of life insurance
18 legislation in this country, on the one
19 hand, to protect, as far as possible, the
20 policyholders and their beneficiaries from
21 the financial shocks which have in the past
22 periodically occurred through decline or
23 disturbance of industry, and on the other
24 hand, to permit the remunerative investment
25 of funds in order to ensure a low cost of
26 insurance consistent with safety, and there
27 must, of course, be a balance between these
28 two objectives, a middle course which will
29 help to avoid the disadvantages of either
30 extreme. An undue restriction in investment



1 would undoubtedly increase the cost of
2 insurance, and the investment of a large
3 proportion of the funds of any company in
4 securities subject to the fluctuation in
5 industrial activity might at some stage
6 cause embarrassment to the company if not
7 loss to the insuring public. The privilege
8 of investment in common stocks may be used
9 to stabilize interest rates in other
10 securities and may yield a fortuitous profit;
11 the exercise of that privilege to an undue
12 extent may involve a hazard not contemplated
13 in the framing of the investment legislation."

14
15 The concern of the Superintendent at that
16 time arose from the fact that one life insurance
17 company then had about 50% of its assets in
18 common stocks, although for all the rest of the
19 companies as a whole the proportion was less than
20 2%. At that time, the Superintendent did not
21 suggest what the limitation might be.

22 In his report for 1930, the Superintendent
23 recommended an amendment that would limit the
24 investments of any company in common stocks to
25 25% of the book value of the total ledger assets
26 of the company. No action was taken on this
27 recommendation but when the Insurance Act was
28 re-enacted in 1932 the Bill, as introduced,
29 contained a proposed limit of 25%. However,
30 during the progress of the Bill through Parliament,



1 an amendment was made on the initiative of
2 representatives of the life insurance companies
3 by which the limit was reduced to 15%. The Bill
4 was enacted in this form and the limit has
5 remained unchanged since that time. Incidentally,
6 it might here be mentioned that there has never
7 been any limitation on the volume of preferred
8 shares. When this whole matter was considered
9 in 1932, the stock market crash of 1929 was fresh
10 in mind and the company referred to above that
11 had such a large proportion of its assets in
12 common stocks was seriously embarrassed. No
13 doubt the views of all concerned were coloured
14 by these facts.

15
16 The present limit is expressed in terms of
17 the book value of common stocks and the book
18 value of the total assets of the company. The
19 book value of stocks is usually the purchase
20 price. Thus if there has been a substantial
21 rise in the market value of common stocks held
22 by an insurance company, the ratio of the market
23 value of common stocks to the market value of
24 all of the assets may be substantially higher
25 than the ratio on the basis of book values.
26 At the end of 1961, taking all Canadian life
27 insurance companies together, the ratio of the
28 book value of common stocks to the book value
29 of total assets was 4.0%; and for individual
30 companies, the ratio ranged from 0.0% to 8.3%.



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common stocks was seriously embarrassed. No
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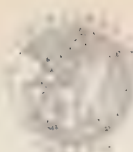
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the book value of common stocks and the book
value of the total assets of the company. The
book value of stocks is usually the purchase
price. Thus if there has been a substantial
rise in the market value of common stocks, as
by an insurance company, the ratio of the market
value of common stocks to the market value of
all of the assets may be substantially higher
than the ratio on the basis of book values.
At the end of 1952, before the American life
insurance companies reformed, the ratio of the
book value of common stocks to the book value
of total assets was 2.0% and for individual
companies, the ratio ranged from 0.1% to 2.5%.



1 On the basis of market values, the ratio for all
2 companies combined was 7.5% and the range for
3 individual companies was from 0.0% to 14.1%.

4
5 Although it may appear inconsistent that the
6 attitude of the companies and the Department
7 concerning the limit on common stocks has been
8 reversed since 1932, it can be seen from the
9 above that, taken as a whole, the companies are
10 not nearly up to the limit now permitted by the
11 Act. In these circumstances, there appeared to
12 the Department to be little case for raising the
13 15% limit at the present time. It would seem to
14 be time enough to give consideration to any
15 possible change when the companies have more
16 nearly approached the existing limit and to do
17 so then in the light of experience with a much
18 larger proportion than has obtained for many
19 years. If any upward revision of the limit were
20 made now, it could hardly be interpreted other-
21 wise than as a direct indication of government
22 policy that companies should place a much larger
23 proportion of their funds in common stocks
24 regardless of their suitability, availability, etc.
25 This, it would seem, would be misleading, improper
26 and unwise.

27 At the time of the amendments in 1961,
28 the strongest representations for a higher limit
29 were made on behalf of British life insurance
30 companies; some of them had reached the 15%



On the basis of market values, the ratio for all companies combined was 7.5% and the range for individual companies was from 0.0% to 14.1%.

Although it may appear inconsistent that the attitude of the companies and the Department concerning the limit on common stocks has been reversed since 1952, it can be seen from the above that, taken as a whole, the companies are not nearly up to the limit now permitted by the Act. In these circumstances, there appears to the Department to be little case for raising the 1952 limit at the present time. It would seem to be time enough to give consideration to any possible change when the companies have more nearly approached the existing limit and to do so then in the light of experience with a much larger proportion than has obtained for many years. If any upward revision of the limit were made now, it could hardly be interpreted other than as a direct indication of government policy that companies should place a much larger proportion of their funds in common stocks regardless of their suitability, availability, and so on. It would seem, would be misleading, however, and unwise.

At the time of the amendments in 1951, the strongest representations for a higher limit were made on behalf of British life insurance companies, and it was decided that the 1952



limit which, in their case, is of necessity based upon the market value of their total deposits. However, the Department could see no justification for raising the limit in these cases, having regard for the fact that non-Canadian companies are not required to maintain any surplus deposits over liabilities in Canada and 15% of deposits in common stocks already exposes the total market value of deposits to substantial fluctuations. Moreover, it must be remembered that this rule applies only to the deposits of non-Canadian companies for the protection of their policyholders in Canada; there is nothing to prevent such companies from investing as much as desired in common stocks or anything else if they wish to do so as head office investments. Further still, at a time when the question of retention of Canadian control of Canadian industries has been much to the fore, it would be difficult to justify a change in rules that would have the effect of permitting, or encouraging, non-Canadian insurance companies to use more of the funds collected from Canadian policyholders or derived from other sources in Canada to purchase Canadian stocks for non-Canadian ownership.

Valuation With respect to the suggestion that the
of
stocks. current market value basis of valuation inhibits
companies from investing more in common stocks,
the view of the Department is that the safety of



limit which, in their case, is of necessity based upon the market value of their total deposits. However, the Government could see no justification for relaxing the limit in these cases, having regard for the fact that non-Canadian companies are not required to maintain any surplus reserves over liabilities in Canada and 10% of deposits in common stocks already exceeds the total market value of deposits in substantial circumstances. Moreover, it must be remembered that this rule applies only to the deposits of non-Canadian companies for the protection of their policyholders in Canada; there is nothing to prevent such companies from investing as much as desired in common stocks or anything else if they wish to do so as head office investments. Further still, at a time when the question of retention of Canadian control of Canadian industries has been much to the fore, it would be difficult to justify a clause in laws that would have the effect of permitting, or encouraging, non-Canadian companies to use more of the funds collected from Canadian policyholders or derived from other sources in Canada to purchase Canadian stocks for non-Canadian ownership.

Valuation. With respect to the suggestion that the current market value basis of valuation should be applied to common stocks, the view of the Department is that the safety of companies from investing more in common stocks



1 the policyholders demands that investments in
2 common stocks be realistically valued and in our
3 opinion the most realistic value is the market
4 value. Any other practice results in placing an
5 artificial value on these assets and the dangers
6 inherent in such practice seem to far outweigh
7 the alleged advantages of encouraging greater
8 investment in common stocks. It seems axiomatic
9 that investment policy as respects common stocks
10 should be closely related to a company's surplus
11 position; a company in a relatively weaker surplus
12 position ought not to risk as large a proportion
13 of its funds in common stocks as a company in a
14 strong surplus position. It would be unfortunate
15 if weaker companies through the use of some
16 arbitrary values were to invest in stocks more
17 heavily than justified by their surplus position;
18 on the other hand, companies in strong surplus
19 positions, with strong investment reserves, are
20 much less likely to be seriously embarrassed by
21 earmarking those reserves to the extent required
22 to cover any market value deficiency. It is at
23 least doubtful whether companies would invest any
24 more heavily in common stocks even if the valuation
25 method were changed; many companies obviously do
26 not regard common stocks as suitable investments
27 for any large proportion of their funds. Also,
28 if a change in valuation method were to encourage
29 some companies to purchase more stocks, it is by
30 no means clear that Canadian stocks would be chosen.



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if weaker companies through the use of some
arbitrary values were to invest in stocks more
heavily than justified by their surplus position;
on the other hand, companies in strong surplus
positions would be encouraged to invest more heavily
in common stocks than is reasonable. It is not
surprising that those reserves to the extent needed
to cover any market value deficiency. It is not
hard to doubt that such companies would invest a
more heavily in common stocks even at the present
method were changed. Any company obviously of
low surplus common stocks as reliable investments
for any large proportion of their funds. It is
in a change in investment method were to encourage
some companies to purchase more stocks, it is
not to be feared that such a change would be



1 The conclusion of the Department, therefore, is
2 that the present valuation basis for stocks should
3 be retained.

4 Valuation Prior to 1950, the Insurance Acts required
5 of Securi- ties all bonds and stocks owned by insurance companies
6 generally. to be taken into account, for annual statement
7 purposes, at market values. However, for deposit
8 purposes, the assets vested in trust by British
9 and foreign companies for their Canadian policy-
10 holders were "accepted" at reduced percentages of
11 the market values, varying from 80% for stocks
12 to 90% for mortgages and corporate bonds and
13 100% for government bonds. In earlier years, it
14 was the practice for all companies to reflect the
15 full market values in their assets but for some
16 years prior to 1950, with the encouragement of
17 the Department, it became the practice for
18 Canadian companies to carry their securities
19 into the balance sheet at the total of the book
20 values or the total of the market values, which-
21 ever was lower. In other words, any excess of
22 total market values over total book values was
23 disregarded for balance sheet purposes. Even
24 where market values were less than book values,
25 it became the practice to set up an investment
26 reserve in the liabilities to cover the deficiency,
27 rather than to make a deduction from the assets.
28 The tendency also grew to maintain investment
29 reserves from year to year and simply to indicate
30 or " earmark " the part required to cover any



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 reserve in the liabilities to cover the difference
 rather than to make a deduction from the assets.
 The tendency also was to maintain investment
 reserves from year to year and simply to indicate



1 market deficiency. This practice helped to avoid
2 any abrupt changes in surplus because of market
3 fluctuations.

4 Apart from the general prescriptions respecting
5 market values in the Acts, there has also been for
6 nearly fifty years a provision (now section 71(5)
7 of the Canadian and British Insurance Companies
8 Act) that if in the opinion of the Minister the
9 market values are unduly depressed, he may, on the
10 report of the Superintendent, authorize the use
11 of higher values but not exceeding the values
12 used for annual statement purposes in the last
13 preceding statement of the company or the book
14 values in the case of assets acquired since the
15 last preceding statement. This provision had
16 its origin at the outbreak of the First Great
17 War when the stock exchanges were suddenly closed
18 and market values were not obtainable. Values
19 prescribed in this manner became known in the
20 industry as "authorized" values and were
21 permitted mainly during and for a few years
22 immediately following the First Great War and
23 again (with attached conditions relating to the
24 payment of dividends to shareholders and policy-
25 holders and to the application of earned surplus
26 to write down book values) during the depression
27 years in the 1930's.

28 From time to time prior to 1950, representatives
29 of the life insurance companies had been pressing
30 for the use of amortized values for bonds, the



market delinquency. This practice helped to avoid
any abrupt changes in supply because of market
fluctuations.

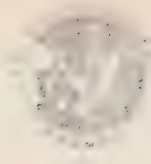
Apart from the general prescription regarding
market values in the Act, there has also been a
recently fifty years a provision (now section 77)
of the Canadian and that the Minister of Finance
Act that in the opinion of the Minister the
market values are not fully depressed, he may, on the
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and market values were not obtainable. Values
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immediately following the First World War and
again (with slight modifications relating to the
payment of dividends to shareholders and policy-
holders and to the application of earned surplus
to write down book values) during the depression
years in the 1930's.

From time to time prior to 1960, amendments
to the 1930's amendments had been proposed



1 same as permitted in the U.S.A. but the Department
2 continually opposed this practice. The attitude
3 of the Department has always been strongly in
4 favour of market values (or book values, if lower)
5 in the belief that this basis is more conservative
6 yet more realistic and tends to keep management
7 more actively in touch with investment conditions,
8 all of which are in the best interests of policy-
9 holders. In the opinion of the Department,
10 adherence to the market value basis has done much
11 to keep Canadian insurance companies strong yet
12 without detriment to policyholders or shareholders
13 as respects the distribution of surplus. Inevitably,
14 too, the attitude of the Department in favour of
15 market values has been influenced by the fact
16 that whatever may be said for amortized values
17 or any other arbitrary values in fair times,
18 long experience has demonstrated that if a
19 company ever gets into difficulties and has to
20 be taken over by another company, the reinsurer
21 will never have regard for anything but current
22 market values.

23
24 In the U.S.A., at the time of the Armstrong
25 investigation in 1905, it was charged that some
26 life insurance companies were retaining too much
27 surplus, were withholding surplus that should be
28 distributed to policyholders and shareholders.
29 As a consequence, provisions were recommended to
30 limit surplus. However, when conditions



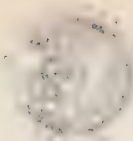
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of the Department has always been strongly in
favor of market values (or book values, if lower)
in the belief that this basis is more conservative
yet more realistic and tends to keep management
more actively in touch with investment conditions
all of which are in the best interests of policy
holders. In the opinion of the Department,
adherence to the market value basis has been
to keep General Insurance companies strong and
without detriment to policyholders or shareholders
as respects the distribution of surplus. However,
too, the attitude of the Department in favor of
market values has been influenced by the fact
that whatever may be said for smoothed values
or any other arbitrary value in this line,
long experience has demonstrated that if a
company ever gets into difficulties and has to
be taken over by another company, the reinsurer
will never have regard for anything but current
market values.

In the U.S.A., at the time of the American
Investment in 1934, it was argued that some
life insurance companies were receiving too much
credit for their surplus and shareholders.
As a consequence, investments were recommended to
be made in the U.S.A. However, when conditions



1 subsequently deteriorated, amortized values were
2 introduced to ease the embarrassment of companies
3 with insufficient surplus. Thus one arbitrary
4 step led to another. Thereafter, amortized values
5 for bonds not in default became the standard basis
6 not only for life companies in the U.S.A. but also
7 for fire and casualty companies. Market values
8 have been retained for stocks but United States
9 companies generally carry into the balance sheet
10 any excess of market values over book values of
11 stocks, which is less conservative than the
12 practice in Canada, particularly in the case of
13 fire and casualty companies. In more recent
14 years, it seems to have been felt in the U.S.A.
15 that the general use of amortized values for
16 bonds is not sufficiently realistic, with the
17 result that companies are now required to build
18 up "mandatory security valuation reserves" which,
19 in effect, are investment reserves against
20 amortized values. Thus the second step seems to
21 have led to a third along the road of arbitrary
22 rules. The more direct recognition of market
23 values seems preferable in Canada.

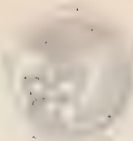
24 In 1950, pressure was renewed from the life
25 insurance companies to be permitted to use
26 amortized values at least for certain classes of
27 bonds and the amendments to the Acts in that year
28 authorized life insurance companies (but not fire
29 and casualty companies) to carry Dominion and
30





1 provincial government bonds, United Kingdom
2 government bonds and United States government
3 bonds at values not exceeding amortized cost
4 prices for annual statement purposes. This
5 limited change was justified on the grounds of
6 the long-term nature of life insurance contracts
7 and the presumption that there is no risk of
8 intrinsic depreciation in the bonds of the
9 governments mentioned.

10
11 Since at that time several classes of assets
12 vested in trust by British and foreign companies
13 were accepted at reduced percentages of the market
14 value, as explained earlier, strong representations
15 were made by such companies to the effect that the
16 treatment accorded to them constituted discrimi-
17 nation as compared with Canadian companies. They
18 therefore pressed for the abolition of the so-
19 called "discounts" on their deposits and, further,
20 for the use of amortized values in the valuation
21 of their deposits. The "discounts" were removed
22 in 1950 but the Department has steadily opposed
23 the use of anything but market values for deposit
24 purposes. The whole purpose of the deposit system
25 is to ensure that sufficient assets are on hand
26 to reinsure the Canadian business of a company,
27 if necessary, and since non-Canadian companies
28 are not required to maintain more than an equiv-
29 alence of assets to cover their liabilities in
30 Canada, and since it is well known that if those
assets ever have to be used to effect reinsurance,



provincial government bonds, United Kingdom

government bonds and United States government

bonds of value not exceeding one hundred pounds

notes for special statement purposes. This

limited charge was justified on the grounds of

the long-term nature of the insurance contracts

and the presumption that there is no risk of

extensive destruction in the event of war

There is also a large number of persons

who are insured by British and foreign companies

who are insured by British and foreign companies

value, it is claimed, is not a serious consideration

were made by such companies to the effect that the

premiums received by them constituted a substantial

portion of the assets of the companies. This

therefore pressed for the abolition of the tax

called "duty" on whole deposits and, further

for the use of mortgaged values in the valuation

of their deposits. The "duty" was removed

in 1950 but the Government has steadily opposed

the use of anything but market value for valuation

purposes. The whole subject of the deposit tax

is so complex that sufficient space is not available

to explain the various phases of a company's

liabilities, and since non-mortgaged companies

are not required to register their assets in public

places of records so cover their liabilities in

general, and hence it is well known that the



1 they will be valued by the reinsurer at market
2 value, it would clearly be unjustifiable to adopt
3 any basis for deposits that results in higher
4 values being placed upon them than could be
5 realized on sale.

6
7 Since 1950, representations have been made
8 by some of the Canadian fire and casualty companies
9 that they too should be permitted to use amortized
10 values for Government bonds for annual statement
11 purposes, the same as the life companies, but the
12 Department has strongly opposed the use of anything
13 but market values by fire and casualty companies,
14 believing that the nature of their business,
15 including catastrophe hazards, is such that the
16 market value basis alone is consistent with the
17 possible need for realizing upon their assets
18 quickly.

19 During the interval since 1950, the life
20 companies have recommended that the use of
21 amortized values be extended, for annual statement
22 purposes, so as to include Canadian, United Kingdom
23 and United States municipal bonds; and, more
24 recently, that all other securities and shares be
25 valued at the average of the three most recent
26 year-end market values. Securities in default or
27 judged to be "intrinsically depreciated", even
28 though not in default, would, of course, be taken
29 at current market values. However, the view of
30 the Department has been that it would be



they will be valued by the market as a whole. It would also be undesirable to allow any rate for deposits that results in higher values being placed upon them than could be realized in sales.

Since 1950, recommendations have been made by some of the Canadian firms and countries, saying that they too should be permitted to use market values for Government bonds for annual statements purposes, the same as the U.S. companies and the Government has strongly opposed the use of market but market values by firms and countries companies, believing that the nature of these business, including radioactive hazards, is such that the market value basis alone is consistent with the possible need for realising upon their assets.

During the interval since 1950, the 1950 companies have recommended that the use of amortized values be extended, for annual statements purposes, so as to include Canadian, United Kingdom and United States companies; and, more recently, that all other countries and firms be valued at the average of the three most recent year-end market values. Reported in detail as judged to be "financially sound", even though not in detail, with an of course, but it



1 unjustifiable to carry some of the weaker municipal
2 securities at amortized values and yet require
3 some stronger corporation bonds to be taken at
4 average market values; that, inevitably, the
5 basis suggested by the companies would soon result
6 in amortized values being used for all terminable
7 securities. Also, the Department has felt that
8 the companies' recommended basis would not be
9 understood by the public, since the primary basis
10 of the balance sheet would be book values but
11 some securities would be taken at amortized values,
12 some at three-year average market values and some
13 at current market values. All things considered,
14 the present basis seems preferable, being more
15 conducive to alertness on the part of management,
16 company strength and public understanding.

17
18 Sometimes, objections to the present basis
19 are raised on the grounds that companies ought
20 not to be exposed to the vagaries of market values
21 on a particular day; that undesirable fluctuations
22 in surplus might induce unwarranted conclusions
23 by the public; that the incidence of surplus
24 distribution might be upset, and that although
25 British insurance companies have traditionally
26 had regard for market values, they nevertheless
27 have more freedom to alter the actuarial
28 valuation bases of liabilities, the implication
29 being that in Canada companies are hamstrung by
30 statutory prescriptions.



unjustifiable to carry some of the weight normally
 accounted at amortized values and yet require
 some stronger composition funds to be taken as
 average market values; that, inevitably, the
 basis suggested by the companies would soon be
 in amortized values being used for all companies
 securities. Also, the Department has felt that
 the companies' recommended basis would not be
 understood by the public, since the primary basis
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 British insurance companies have traditionally
 had regard for market values, they nevertheless
 have more freedom to alter the actuarial
 valuation based on liabilities, the implication
 being that in Canada companies are hampered by
 statutory provisions.



1 There are at least partial answers to all of
2 these objections. Under the Acts, market values
3 may be taken as at December 31 or, in the discretion
4 of the Superintendent, at any date not more than
5 sixty days prior thereto. Consequently there is
6 some latitude if special conditions should exist
7 toward the end of any year. In practice, but not
8 always, values are taken as at November 1 so that
9 they may be available for use soon after the end
10 of the year. If very special (depressed) conditions
11 should exist, the Minister may authorize values
12 not exceeding those of the previous year. Thus
13 there are some protective facilities against the
14 vagaries feared. At the same time, it must be
15 emphasized that since the current practice is to
16 earmark investment reserves to cover any
17 deficiency under book values, it is not surplus
18 that normally fluctuates but rather the part of
19 the investment reserve that is indicated as
20 required to cover any such deficiency. There-
21 fore, no particular hardship results. Further,
22 if the fact is that market values have declined
23 substantially, it seems only right that such fact
24 should be reflected in some manner in the balance
25 sheet; otherwise, the public might erroneously
26 conclude that the business of insurance is immune
27 from the effect of any such fluctuations. As
28 respects the incidence of surplus distribution,
29 if a company's investment reserves are reasonably
30 adequate, the surplus account does not suffer



There are at least partial answers to all of these objections. Under the Act, market values may be taken as at December 31 or, in the absence of the Superintendent, at any date not more than sixty days prior thereto. Consequently there is some latitude of special conditions should exist toward the end of any year. In practice, but not always, values are taken as at November 1 so that they may be available for use soon after the end of the year. If very special (depressed) conditions should exist, the Minister may authorize values not exceeding those of the previous year. Then there are some protective facilities against the vagaries of the market. At the same time, it must be emphasized that since the current provision in the company's investment reserves to cover any deficiency under book values, it is not surprising that normally fluctuations but rather the part of the investment reserve that is indicated as required to cover any such deficiency. Therefore, no particular hardship results. Further, if the fact is that market values have declined substantially, it seems only right that such fact should be reflected in some manner in the balance sheet. It is concluded that the business of insurance is insured from the effect of any such fluctuation. As respects the inclusion of surplus in distribution, if a company's investment reserves are reasonably



1 from market fluctuations; if such reserves are
2 inadequate and if market fluctuations then fall
3 upon surplus to the point of embarrassment, there
4 may be reason for reconsidering the current divid-
5 end formula. In comparison with British practice,
6 the freedom that British companies have to alter
7 their actuarial bases is largely attributable
8 to the fact that they have not gone as far in
9 guaranteeing policy loans and non-forfeiture
10 values as companies in North America. The
11 practice on this continent as respects loans and
12 non-forfeiture values is such that companies are
13 more restricted by the existence of these
14 guaranteed values in their policies than by
15 statutory valuation prescriptions.

16 Briefly, in the opinion of the Department,
17 the present basis of valuation of securities
18 is satisfactory and should be retained. There
19 appears to be no reason for thinking that such
20 basis interferes in any way with the flow of
21 funds or capital investment; on the contrary,
22 extension of the use of amortized values or the
23 use of other arbitrary values is believed to be
24 much more likely to have dampening effects. Once
25 a principle is accepted, however limited the
26 application of the principle may originally have
27 been intended, it tends to grow. This is
28 illustrated by the extension of the use of
29 amortized values by banks and loan and trust
30 companies. The Bank of Canada adopted amortized

from market fluctuations; in such cases the
 insurance and re-insurance (from 1911
 upon surplus to the point of endorsement) there
 may be reason for reconsidering the current value
 and formula. In connection with British practice
 the freedom from British control is not to be
 their national basis in largely distributed
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 practice on this continent as respects loans and
 non-monetary values is such that companies are
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Finally, in the opinion of the Department,
the present basis of valuation or revaluation
is satisfactory and should be retained. There
 appears to be no reason for changing that and
 basic interests in any way with the flow of
 funds or capital investment on the continent.
 extension of the use of amortized values on the
 use of other arbitrary values is believed to be
 when more likely to have damaging effects. In
 a principle is a sound, however limited the
 application of the principle may otherwise be
 been proposed, it tends to grow. This is
 illustrated by the extension of the use of
 amortized values by banks and insurance companies



1 values for Dominion and provincial government
2 bonds in its balance sheet at the end of 1956.
3 Authorization of the same practice for chartered
4 banks soon followed by Order in Council in 1957
5 and then for Quebec Savings banks by an amendment
6 to their governing Act later that year. Inevitably,
7 this led to amendments to the Loan Companies Act
8 and the Trust Companies Act in 1958 authorizing
9 the same practice for Dominion loan and trust
10 companies. The view of the Department is that
11 where the liabilities are of short term, including
12 demand deposits, market values provide the most
13 realistic basis of valuation for all securities,
14 especially if there appears to be any prospect
15 of having to realize upon the securities before
16 maturity.

17 Policy
Loans.

18 For some years up to 1928, the ratio of
19 policy loans in Canada to policy reserves in
20 Canada, for all federally registered life
21 insurance companies combined, was quite uniform
22 at about 15%. Thereafter, a marked increase in
23 the volume of loans and in the ratio occurred
24 until a maximum of 20.9% was reached in 1932.
25 A gradually-reducing ratio then ensued until
26 1938 when it reached 15.8%, being approximately
27 the same as obtained for several years prior to
28 1928 when the rise began. After 1938, the ratio
29 steadily declined further to 5.8% in 1949 and
30 has remained at approximately the same level
ever since. For Canadian companies alone,



various for Dominion and provincial governments
bonds in the balance sheet at the end of 1957
and the Government of the same amount for interest
and then for Quebec Savings banks by an amount
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and the Trust Companies Act in 1958 authorizing
the same practice for Dominion, Provincial and
municipal. The view of the Government is that
where the liabilities are of short term, including
demand deposits, market values provide the most
realistic basis of valuation for all securities,
especially if there appears to be any prospect
of having to realize upon the securities before

for some years up to 1958, the ratio of
policy loans in Canada to policy reserves in
Canada, for all federally registered life
insurance companies combined, was quite uniform
at about 100%. Thereafter, a marked increase in
the volume of loans and in the ratio occurred
until a maximum of 150% was reached in 1958.
A gradually-reversing ratio then ensued until
1968 when it reached 100%, and approximately
the same as obtained for several years prior to
1968 when the rise began. After 1968, the ratio
steadily declined further to 50% in 1974 and
has remained at approximately the same level.

Policy
Loans



1 considering loans both in and out of Canada, the
2 ratio in 1961 was 6.3% in reference to policy
3 reserves or 4.9% in reference to total assets.

4 The rate of interest charged on policy loans
5 varies from time to time but a maximum rate is
6 usually included in the policy provisions. In
7 policies issued many years ago, a maximum interest
8 rate of 7% was frequently specified but some
9 policies also provided for an additional expense
10 charge up to 4%. However, for the last 25 years
11 or more, the maximum rate specified in policies
12 has been 6%, sometimes 5%, and the maximum over-
13 all rate charged has been 6% regardless of policy
14 provisions permitting a higher rate. At pages
15 2401-3 of the evidence given at the presentation
16 of the Brief of the Canadian Life Insurance
17 Officers Association, some doubt was indicated
18 about the origin of the maximum rate of 6% that
19 has now prevailed so long in Canada. From 1910
20 until 1932, the Insurance Act specified certain
21 provisions that were to be included in all life
22 insurance policies issued in Canada and one such
23 provision fixed the maximum rate on policy loans
24 at 7%. These requirements were omitted from the
25 new Acts passed in 1932, following the decision
26 of the Privy Council in 1931. In 1935, a member
27 of Parliament introduced a private bill that
28 would have set the maximum rate at 4% but
29 following discussion the companies through the
30 Association gave an undertaking that they would



comparing loans both in and out of Canada, the
rate in 1981 was 0.75% in reference to policy
reserves on 0.75% in reference to total assets.
The rate of interest charged on policy loans
varies from time to time but a maximum rate is
usually included in the policy provisions. In
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rate of 1% was frequently specified but some
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charges up to 1%. However, for the last 25 years
or more, the maximum rate specified in policies
has been 1%, sometimes 1.5%, and the maximum over-
all rate charged has been 2% regardless of policy
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of Parliament introduced a private bill that
would have set the maximum rate at 4% but
following discussion the committee through the



1 not thereafter charge an effective annual rate
2 exceeding 6% per annum and on this understanding
3 the bill was withdrawn. This was the origin of
4 the practice that has been followed ever since.

5
6 Control of Canadian Insurance Companies

7 There are not many major industries in
8 Canada in which the leading part is played by
9 Canadian companies that have been built up
10 entirely by Canadian capital, Canadian management
11 and personnel, and Canadian "know how" in general.
12 The business of life insurance is one of the few
13 such industries. From this point of view alone,
14 it is understandable why there is strong public
15 sentiment in favour of retaining control of
16 Canadian life companies in Canada. However,
17 since these companies also accumulate savings
18 giving rise to large pools of funds for invest-
19 ment, there are economic reasons as well that
20 make Canadian direction of such companies
21 desirable.

22 Prior to 1929, all Canadian life companies
23 were controlled in Canada. In that year, control
24 of one relatively small company passed to British
25 hands but there was no other case until 1954.
26 Since the latter year, control of seven more
27 companies has been acquired by various insurance
28 interests outside Canada. In most cases, it would
29 appear that one of the main objectives was to
30 acquire an existing agency organization in order



not interested in an effective change in the
exceeding 65 per centum and on this withdrawal
the bill was withdrawn. This was the origin of
the practice that has been followed ever since.

Control of Canadian Insurance Companies

There are not many major industries in
Canada in which the leading part is played by
Canadian companies that have been built up
entirely by Canadian capital, Canadian management
and personnel, and Canadian "know how" in general.
The business of life insurance is one of the few
such industries. From this point of view, it is
it is understandable why there is strong public
sentiment in favour of retaining control of

since these companies also accumulate savings
giving rise to large pools of funds for invest-
ment, there are economic reasons as well that
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Prior to 1929, all Canadian life companies
were controlled in Canada. In that year, control
of one relatively small company passed to British
hands but there was no other case until 1931.
Since the latter year, control of seven more
companies has been acquired by various foreign
interests outside Canada. In most cases, it now
appears that one of the main objectives has been



1 to transact business in Canada and so avoid the
2 arduous and expensive task of building such a
3 force from scratch. All of these companies were
4 relatively small except one which was of medium
5 size. Four other federally-incorporated life
6 companies have been started in recent years, all
7 on the basis of external capital.

8
9 At the end of 1961, the 36 federally-
10 registered Canadian companies transacting the
11 business of life insurance had 68.6% of the
12 total life insurance in force in Canada in all
13 federally-registered companies (Canadian, British
14 and foreign). Of these 36 Canadian companies,
15 12 were controlled out of Canada but they had
16 only 5.2% of the total amount in force in Canada,
17 leaving 63.4% in the hands of Canadian-controlled
18 companies. In addition, there is, of course, the
19 amount in force in provincial companies which is
20 approximately 5% of the total, being about the
21 same amount as in the 12 Canadian companies that
22 are now controlled outside Canada.

23 By 1957, it had become clear that other,
24 larger companies might be acquired by various
25 non-Canadian interests. Consequently, in that
26 year, the Canadian and British Insurance
27 Companies Act was amended so as (1) to require
28 that a majority of the whole board of directors
29 of every federally-incorporated insurance company
30 must be Canadian citizens ordinarily resident in



to transfer business in Canada and so avoid the
arduous and expensive task of building such a
force from scratch. All of these companies were
relatively small except one which was of medium
size. Four other federally-incorporated firms
companies have been started in recent years, all
on the basis of external capital.

At the end of 1961, the 30 federally-
registered Canadian companies transacting the
business of life insurance had 88.6% of the
total life insurance in force in Canada in all
federally-registered companies (Canadian, British
and foreign). Of these 30 Canadian companies,
12 were controlled out of Canada but very had
only 5.2% of the total amount in force in Canada
leaving 83.4% in the hands of Canadian-controlled
companies. In addition, there is, of course, the
amount in force in provincial companies which is
approximately 5% of the total, being about the
same amount as in the 12 Canadian companies now
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By 1967, it had become clear that certain
larger companies might be acquired by various
non-Canadian interests. Consequently, in that
year, the Canadian and British Insurance
Companies Act was amended so as (1) to require
that a majority of the whole board of directors
of every federally-incorporated insurance company



1 Canada; (2) to authorize the board of directors
2 of federally-incorporated life companies to refuse
3 to sanction the transfer of shares from Canada
4 out of Canada, if they so desire; and (3) to permit
5 federally-incorporated life companies to mutualize
6 if they wish to do so and are in a position to do
7 so. As a result, 5 companies are in the process
8 of mutualization and they have 24.8% of the total
9 life business in force in Canada in all federally-
10 registered companies. Although mutualization has
11 been mentioned here in connection with the control
12 of companies, it should be emphasized that some
13 companies had been giving consideration to the
14 possibility of mutualization for years, quite
15 apart from any question of control.

16
17 Since control of most of the 8 companies
18 referred to was acquired by non-Canadian life
19 insurance interests, the question has been raised
20 why Canadian life insurance companies did not
21 take the initiative and purchase control. The
22 first main reason is that there has been a
23 prohibition in the Insurance Act since 1910
24 against investing the life insurance funds of a
25 federally-incorporated insurance company in the
26 shares of any other company transacting the
27 business of life insurance. This prohibition
28 was recommended by the Canadian Life Insurance
29 Officers Association in a memorandum submitted
30 to the Government in 1908 when the first bill



Canada: (a) to authorize the board of directors

of Federally-incorporated life companies to

to acquire the business of insurance from

out of Canada, in any or during; and (b) to

federally-incorporated life companies to

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of incorporation and they have 98.4% of the

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1 to enact a new Insurance Act was under consider-
2 ation after the Royal Commission's report in 1907.
3 Presumably, it was felt desirable to prevent
4 Canadian life companies from interfering or taking
5 any hand in the affairs of other life companies
6 and also to avoid the complications and dangers
7 that had shown up in the operation of subsidiary
8 companies at that time.

9
10 Since this prohibition results in the
11 apparent anomaly of Canadian life companies being
12 prevented from purchasing control of other Canadian
13 life companies while some companies incorporated
14 elsewhere are not so prevented, there have been
15 suggestions that the existing prohibition should
16 be repealed. Rather strangely, the strongest
17 suggestions for repeal have come from a few small
18 mutual companies that seemingly desire to purchase
19 stock companies in order to grow at a faster rate
20 than otherwise seems possible. All things
21 considered, however, the view of the Department
22 has been that repeal would create more problems
23 than it would solve and would not be in the best
24 interests of policyholders or the insuring public.

25 At this point, it should be mentioned that
26 there has also been in the Insurance Act since
27 1910 a provision whereby one company may take
28 over the business of another company by an
29 agreement providing for the purchase, sale and
30 transfer of assets, liabilities and business,



to enact a new Insurance Act was under consideration after the Royal Commission's report in 1947. Presumably, it was felt desirable to prevent Canadian life companies from interfering or taking any hand in the affairs of other life companies and also to avoid the complications and delays that had shown up in the operation of such life companies at that time.

Since this prohibition results in the apparent anomaly of Canadian life companies being prevented from purchasing control of other life companies while some companies incorporated elsewhere are not so prevented, there have been suggestions that the existing prohibition should be repealed. Rather strangely, the strongest suggestions for repeal have come from a few "mutual" companies that seemingly desire to purchase stock companies in order to grow at a faster rate than otherwise seems possible. All things

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At this point, it would be mentioned that there has also been in the Insurance Act since 1947 a provision whereby one company may take over the business of another company by an agreement providing for the purchase, sale and



1 but any such agreement is ineffective until
2 sanctioned by the Treasury Board. The policy up
3 to date, however, has been against agreements of
4 this kind in the case of life companies unless
5 necessary or desirable to protect the interests
6 of policyholders. This policy has been based
7 upon the view that there have not been too many
8 Canadian life insurance companies in the field
9 and it is desirable to retain the identity of
10 those already operating, particularly having
11 regard for the difficulties and waste inherent
12 in the launching of new companies. If the
13 number of federally-incorporated life companies
14 were to decrease materially, it is likely that
15 this would be followed by a wave of new companies
16 being incorporated, either federally or
17 provincially. With this prospect, it seems
18 better to see the present companies continue in
19 existence.

20 There are other reasons why it is undesirable
21 to see life companies merge or otherwise go out
22 of business unnecessarily. Presumably most
23 persons choose their life company with some
24 circumspection, some persons preferring mutual
25 companies as against stock companies or vice
26 versa, some being attracted by particular practices
27 followed as respects investments or by management
28 practices in other respects or by management
29 itself, etc. Having taken out a policy in a
30 particular company, the policyholder counts on



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There are other reasons why it is undesirable
to see life companies merge or otherwise go out
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persons choose their life company with some
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companies as a class, or with companies as a
class, some being attracted by particular plans
followed as respects investments or by management
practices in other respects or by management
itself, etc. Having taken out a policy in



1 the continued existence of that company and its
2 practices. However, if unnecessary mergers are
3 permitted, policyholders may find themselves
4 in another company following quite different
5 policies and practices. Any such shunting around
6 of policyholders seems undesirable. Furthermore,
7 mergers may be upsetting to agents and employees
8 as well as policyholders.

9
10 Under existing rules and policies, even if
11 control changes, the identity of a Canadian life
12 company is preserved and at least some of the
13 upsetting effects referred to above are likely
14 to be avoided. There is also the possibility
15 that at some future date control may be repatriated.
16 In any event, the company must continue to operate
17 without any structural change and in accordance
18 with the statutes applicable to it.

19 If the present prohibition against Canadian
20 life companies purchasing the shares of other
21 life companies were repealed, and if the shares
22 of another company were purchased, it would simply
23 be the first step toward absorption and disappear-
24 ance of that company. For the reasons indicated
25 above, this would be undesirable. Yet there would
26 be no purpose in the purchasing company operating
27 the purchased company as a subsidiary in the same
28 field in Canada and it would be uneconomical to do
29 so. If a Canadian life company were bidding against
30 a non-Canadian company for ownership of another



the continued existence of that company and its practices. However, if unnecessary mergers are permitted, policyholders may find themselves in another company following quite different policies and practices. Any such shifting around of policyholders seems undesirable. Furthermore, mergers may be objectionable to agents and employees as well as policyholders.

Under existing rules and policies, even if control changes, the identity of a Canadian life company is preserved and at least some of the company's business is preserved. There is also the possibility that at some future time control may be required. In any event, the company must continue to operate without any structural change and in accordance with the statutes applicable to it.

If the present prohibition against transferring life companies by retaining the shares of other life companies were repealed, and if the shares of another company were purchased, it would result in the first step toward absorption and liquidation of that company. For the reasons indicated above, this would be undesirable. Yet, there would be no purpose in the transferring company operating as a separate entity in the future and it would be unreasonable to require it to do so. If a Canadian life company were absorbed by another



1 Canadian life company, it seems probable that
2 in most cases the non-Canadian bidder could
3 justifiably offer a better price since it would
4 be seeking to acquire something it has not got
5 in Canada, namely, an existing organization.
6 A Canadian company, as purchaser, would likely
7 have to pay such a high price as to make it
8 questionable whether the purchase would be in
9 the best interests of its own policyholders.

10
11 Furthermore, repeal might easily kindle a
12 bonfire of desire on the part of several companies
13 to grow quickly through the acquisition of other
14 companies. Quite likely, the larger companies
15 could make the best offers and it is possible
16 that many, perhaps most, of the small stock
17 companies might disappear, only to be followed
18 by the incorporation of many other new ones.
19 Stock companies could not take over mutual
20 companies since the latter have no shares to
21 purchase. On the other hand, it would seem to
22 raise a question of principle if mutual companies
23 were to take over stock companies ostensibly to
24 keep control of the latter in Canada but
25 actually resulting in the disappearance of the
26 purchased companies. If a stock company were to
27 take over another stock company, there could be
28 no certainty that the purchasing company might
29 not itself be acquired later by non-Canadian
30 interests, control of the combined companies thus



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1 passing from Canada. An actual illustration of
2 the latter, by turning to the field of fire and
3 casualty companies, may give this possibility
4 some degree of realism.

5 Almost from the beginning, some Canadian
6 fire and casualty companies have been owned or
7 controlled outside Canada. In fact, several of
8 them were started by British and foreign insurance
9 companies already operating in Canada. At present,
10 only 48 of the 108 Canadian companies registered
11 to transact fire insurance or some class of
12 casualty insurance are controlled in Canada.
13 During the 1920's, there was a strong tendency
14 for Canadian fire insurance companies to be
15 bought up by British and foreign companies so as
16 to provide additional agency outlets among other
17 things. For a time, it looked as though most,
18 if not all, of the purely Canadian fire insurance
19 companies might disappear and there were many
20 suggestions that something should be done to stop
21 the trend. At that time, Canadian fire and
22 casualty companies were also unable to purchase
23 the shares of other insurance companies but in
24 1927 an amendment was made to the Insurance Act
25 permitting such purchases, within certain limits.
26 This was done for the same reason as more recently
27 advanced in respect of life companies, namely, to
28 help keep control of Canadian fire and casualty
29 companies in Canada by enabling control to be
30 purchased by other Canadian fire and casualty



1 companies. However, the amendment has had little
2 practical effect and it is interesting to note
3 that the largest group of Canadian companies
4 which pressed the strongest for such an amendment
5 in 1927 was itself purchased in its entirety in
6 1961 by a British group of companies.

7
8 Briefly, in the opinion of the Department,
9 more harm than good would result from any
10 similar amendment respecting Canadian life
11 insurance companies.

12 Business of Canadian Insurance Companies
13 outside Canada

14 Several Canadian life insurance companies
15 have for a great many years transacted business
16 outside Canada, mainly in the U.S.A. but also
17 in the United Kingdom and other areas spread
18 practically around the globe. In doing so, they
19 have established an enviable reputation which is
20 second to none amongst life insurance companies
21 everywhere. Although new business has been
22 discontinued for a variety of reasons in several
23 areas, the volume of life business transacted by
24 Canadian companies outside Canada has not
25 diminished either in proportion to the total
26 volume transacted by all Canadian life companies
27 both in and out of Canada or in proportion to the
28 life business of British and foreign companies
29 in Canada. At the end of 1961, 29% of the
30 total life insurance in force in Canadian
companies was out of Canada and the volume of



1 their life business outside Canada was approximately
2 the same as that of all British and foreign
3 companies in Canada. The situation is essentially
4 the same even if one considers only Canadian life
5 companies that are controlled in Canada since the
6 foreign operations of Canadian life companies
7 controlled out of Canada are relatively small.

8
9 In the fire and casualty insurance field,
10 however, the situation is very different. Only
11 13% of the total net premiums written by all
12 Canadian companies in 1961, both in and out of
13 Canada, arose from business out of Canada and
14 nearly half of this percentage represented the
15 personal accident and sickness business transacted
16 by Canadian life insurance companies outside
17 Canada. Also, there is nothing approaching an
18 equivalence in the fire and casualty field, as
19 there is in the life field, between the foreign
20 business of Canadian companies - especially
21 Canadian-controlled companies - and the Canadian
22 business of British and foreign companies.
23 British and foreign companies do about twenty-
24 five times as much fire and casualty business
25 in Canada as Canadian-controlled companies do
26 outside Canada; and if the personal accident and
27 sickness business of life companies is excluded,
28 the multiple is increased to nearly one hundred
29 times.
30



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companies in Canada. The situation is somewhat
the same even if one considers only Canadian life
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Up to date, the foreign operations of Canadian insurance companies - life, fire and casualty - have all been carried on through branch offices or agency connections rather than through subsidiary companies incorporated in foreign lands. The Act permits Canadian companies to deposit assets outside Canada to the extent required by foreign laws or as may be necessary for the maintenance of any foreign branch or branches; and the existing rules seem to have served their purpose very well, judging by the success of Canadian life companies in foreign fields. Apart from the U.S.A., it has not usually been necessary to deposit assets in other countries in excess of the liabilities in such countries. Consequently, in those countries where Canadian companies have found it necessary to withdraw through nationalization of the business or otherwise, the problems have been less serious than would have obtained if assets in those countries had exceeded the companies' liabilities there. However, there have been a few instances where Canadian companies had assets in excess of liabilities in foreign lands and considerable difficulty was experienced in obtaining the release of the excess.

In the evidence following presentation of the Brief of the Canadian Life Insurance Officers Association, it was suggested that in some

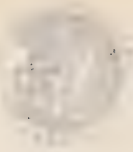
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1 countries it might be advantageous to Canadian
2 companies if they could operate through a
3 subsidiary company, presumably incorporated in
4 the country concerned, rather than on a branch
5 office or agency basis. The thought seemed to
6 be that if problems were to arise, as in Cuba,
7 the parent Canadian company would be insulated
8 from any adverse effects which would fall upon
9 the local subsidiary instead. It would seem,
10 however, that more could be said against than
11 in favour of this suggestion.

12 In the first place, it is very doubtful
13 whether local subsidiaries would have had
14 anything like the same attraction as the Canadian
15 companies themselves to the residents of many
16 foreign countries where our companies have built
17 up a substantial volume of business. One of
18 the great attractions appears to have been the
19 financial strength and reputation of Canadian
20 insurance companies, their independence of
21 unstable local governments, also of local monetary
22 and economic problems, and the knowledge that all
23 of the assets of a Canadian company are behind
24 its policies. This kind of attraction would be
25 almost completely absent in the case of a local
26 subsidiary company. Secondly, it is inevitable
27 in the case of a subsidiary that the assets
28 maintained locally would always be not merely
29 equal to, but would always exceed, the local
30 liabilities, at least to the extent of the



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1 subsidiary's capital and surplus. Thus in the
2 event of the business in any such country being
3 taken over, or other trouble developing, the
4 parent would stand to lose more than through the
5 present branch office method. In the light of
6 experience, it appears fortunate that Canadian
7 companies were not operating through subsidiaries
8 in some countries. So far as any criticism or
9 adverse reaction on the part of policyholders is
10 concerned, it must be doubtful, if trouble
11 develops, whether the parent company would ever
12 be absolved by the existence of a subsidiary
13 company. Further, if subsidiaries were permitted,
14 it would seem that they could only be utilized by
15 stock companies since it would hardly be justifiable
16 for a mutual company to abandon the mutual
17 principle by setting up a joint stock subsidiary
18 company. If one considers all aspects, including
19 experience in foreign countries up to date, the
20 case for repealing the existing prohibition
21 against investing life insurance funds in the
22 shares of another life company, so as to permit
23 the formation of subsidiary companies deeply
24 rooted in foreign countries, would appear to be
25 surrounded by far more disadvantages than
26 advantages.

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Loan and Trust Companies

Supervision of all Dominion loan* and trust companies and similar companies incorporated by the provinces of Manitoba, New Brunswick and Nova Scotia is carried out by the Department in substantially the same manner as for insurance companies, involving the filing of detailed annual statements, examinations at the head offices of the companies, etc. Broadly speaking, the loan companies supervised by the Department have assets constituting about three-quarters of the aggregate assets of all Dominion and provincial loan companies operating in Canada. The trust companies supervised by the Department constitute a smaller proportion of the trust field, being about one-third on the basis of assets in company and guaranteed funds and about one-quarter on the basis of assets belonging to estates, trusts and agencies. Most, but not all, of the loan and trust companies supervised by the Department accept deposits but none transacts business out of Canada.

Supervision of these companies, like the supervision of insurance companies, is designed mainly to protect the public doing business with them. It will be obvious that solvency

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1 is the prime factor in the supervision of loan
2 companies which accept deposits and issue
3 debentures and likewise in the supervision of
4 trust companies as respects their own funds and
5 guaranteed trust funds (the latter comprising
6 trust deposits and guaranteed investment
7 certificates). However, there is no question
8 of solvency so far as the administration of
9 estates, unguaranteed trusts and agencies are
10 concerned.

11 In order to ensure that persons placing
12 money on deposit with Dominion companies or
13 purchasing their debentures or acquiring their
14 guaranteed investment certificates are
15 protected by sufficient capital and reserves,
16 the Loan Companies Act and the Trust Companies
17 Act of Canada have, from the time of their
18 enactment in 1914, placed limits on the aggregate
19 volume of money borrowed from the public in these
20 ways or borrowed in any other way. Originally,
21 the Loan Companies Act limited borrowed money
22 to four times the company's paid-up capital
23 and reserve; this limit was increased to six
24 times in 1927, ten times in 1948 and twelve and
25 one-half times in 1958. The original limit in
26 the Trust Companies Act in 1914 was five times
27 the company's paid-up capital and reserve, such
28 limit being increased to seven times in 1931,
29 ten times in 1947 and twelve and one-half times
30 in 1958.

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protected by sufficient capital and reserves,
the Loan Companies Act and the Trust Companies
Act of Canada have, from the time of their
enactment in 1904, placed limits on the aggregate
volume of money borrowed from the public in the
ways or borrowed in any other way. Originally
the Loan Companies Act limited borrowed money
to four times the company's paid-up capital
and reserve; this limit was increased to six
times in 1924, ten times in 1940 and twelve and
one-half times in 1958. The original limit in
the Trust Companies Act in 1914 was five times
the company's paid-up capital and reserve, and
limit being increased to seven times in 1931,
ten times in 1947 and twelve and one-half times



1 The present limit of twelve and one-half
2 times for both loan and trust companies means
3 that depositors, debenture holders and guaranteed
4 certificate holders have a protective margin of
5 $\frac{1}{13.5}$ or 7.4%. In other words, the assets
6 standing behind these borrowed moneys, the
7 capital and the reserve, could shrink by 7.4%
8 before there would be a deficiency of assets as
9 compared with borrowed money alone. Over the
10 years, the companies have from time to time
11 pressed for further extensions of this limit
12 in order to permit expansion of their business
13 and in the Brief submitted by the Trust Companies
14 Association of Canada a renewed request for a
15 limit of fifteen times is made. This would
16 reduce the protective margin to $\frac{1}{16}$ or 6.2%.

17
18 Having regard for the fact that these
19 companies are permitted to use amortized values
20 for government bonds, that they invest large
21 proportions of their funds in real estate
22 mortgages, that they have substantially the
23 same investment powers as insurance companies,
24 that their liabilities are essentially of
25 short-term nature and to a certain extent may
26 be payable on demand, that fluctuations in the
27 market values of securities have frequently
28 occurred to the extent of 6% or more during a
29 relatively short period, that such companies
30 have no definite relationship with the Bank of
Canada, or any other lender of last resort,



1 and for other reasons, the view of the
2 Department is that the present protective margin
3 is not larger than necessary and hence that the
4 present borrowing limit is about as high as it
5 is safe to go. As a consequence, the Department
6 has not felt in the past, nor does it feel now,
7 that it could support the request of the
8 companies in this respect. This does not mean
9 that a company having reached its borrowing limit
10 must cease expansion; it can do so by increasing
11 its capital or by waiting until its reserve
12 position is strengthened through earnings.

13
14 As respects jurisdiction, if the business of
15 accepting deposits from the public, more
16 particularly with chequing privileges and where
17 the repayment of the deposit or payment of
18 interest thereon is guaranteed by the company,
19 constitutes deposit banking or, more briefly,
20 banking, there would seem to be room for doubt
21 whether provincially-incorporated companies -
22 especially loan companies - may validly be
23 given the necessary powers by provincial legis-
24 latures to carry on this form of business which,
25 under the constitution, falls exclusively within
26 the legislative jurisdiction of Parliament. In
27 the case of loan companies, the relationship
28 between the company and depositors is that of
29 debtor and creditor. In the case of trust
30 companies, the relationship is theoretically one
of trust but the practical result is essentially

and for other reasons, the view of the Department is that the present protective measure is not larger than necessary and hence that the present borrowing limit is about as high as it is safe to go. As a consequence, the Department has not felt in the past, nor does it feel now, that it could support the request of the companies in this respect. This does not mean that a company having reached its borrowing limit must cease expansion; it can do so by increasing its capital or by waiting until its reserve position is strengthened through earnings.

As respects liquidation, if the business of accepting deposits from the public, more particularly with checking privileges and when the repayment of the deposits or payment of interest thereon is guaranteed by the company, constitutes deposit banking or, more briefly, banking, there would seem to be room for doubt whether provincially-incorporated companies - especially loan companies - may validly be given the necessary powers by provincial legislatures to carry on this form of business while under the constitution, falls exclusively within the legislative jurisdiction of Parliament. In the case of loan companies, the relationship between the company and depositors is that of debtor and creditor. In the case of insurance companies, the relationship is theoretically



1 the same. This question is raised mainly because
2 the Department is presently charged with the
3 responsibility for supervising some provincially-
4 incorporated loan and trust companies that are
5 carrying on a deposit business.

6 Licensees under the Small Loans Act

7 This Act applies to cash loans made in
8 amounts up to \$1,500 and the number of licensees
9 as well as the number of branch offices of
10 licensees show a continual tendency to increase.
11 Although complaints were widespread and strong
12 in this field prior to the enactment of this
13 legislation in 1939, the number received now by
14 the Department is very small. Apart from a
15 few minor clerical errors in charges to
16 borrowers which are promptly corrected when
17 pointed out by the Department's examiners, the
18 Act is rigidly observed and enforced. By far
19 the greatest number of complaints received by
20 the Department relate to charges on loans over
21 \$1,500 (especially loans secured by second or
22 third mortgages on real estate) and conditional
23 sale agreements (especially in connection with
24 the amount of credit allowed when contracts
25 are prepaid), to neither of which fields does
26 the Small Loans Act apply nor does the Department
27 at present have any authority or responsibility.

28
29 The responsibility resting on the Department
30 in connection with the Small Loans Act is quite

the name. This question is raised mainly because the Department is presently charged with the responsibility for supervising some provisions incorporated into and those companies that are carrying on a deposit business.

Liabilities of the Small Loans Act

This Act applies to cash loans made in amounts up to \$1,500 and the number of licensees as well as the number of branch offices of licensees show a continual tendency to increase. Although complaints were witnessed and action in this field prior to the enactment of this legislation in 1939, the number received now by the Department is very small. Arising from a few minor clerical errors in charges to borrowers which are promptly corrected when pointed out by the Department's examiners, the Act is rigidly observed and enforced. By far the greatest number of complaints received by the Department relate to charges of loans over \$1,500 (especially loans secured by record on third mortgages on real estate) and conditions sale agreements (especially in connection with the amount of credit allowed when contracts are provided), to neither of which this report the Small Loans Act, and may not does the Department at present have any authority or responsibility. The responsibility resting on the Department is in the Small Loans Act is to



1 different from that in connection with most of
2 the other Acts administered by the Department.
3 Under the Small Loans Act, the main question is
4 not the solvency of the company (though this may
5 be important if debentures have been issued to
6 the public) but the enforcement of the terms of
7 the Act specifying the maximum charges that may
8 be made to borrowers.

9
10 Dominion authority in this field arises by
11 reason of the jurisdiction over "interest"
12 given to the Dominion under the British North
13 America Act; this explains the large number of
14 provincially-incorporated companies licensed
15 under the Small Loans Act.

16 In this connection, it may be noted that
17 the Small Loans Act does not attempt to define
18 "interest" but instead places a maximum on the
19 charges that may be made by the lender to the
20 borrower, regardless of whether the charges or
21 any part of them are called interest, expenses,
22 commission or any other name. Experience with
23 earlier legislation, and experience in other
24 countries, has proved that effective supervision
25 of money-lending can only be accomplished through
26 the placing of a maximum limit on all charges,
27 by whatever name called, made by the lender.
28 Even if it be argued that all charges made by
29 the lender are not truly "interest", the fact
30 is that unless control is exercised over all



1 charges, control over "interest" would be
2 ineffective.

3
4 This is a matter of great importance in the
5 supervision of money-lenders but it is also
6 relevant in connection with the discussion
7 that arises from time to time about the possible
8 supervision of sales finance companies and
9 companies lending on the security of second and
10 third mortgages on real estate.

11 Central Co-operative Credit Societies

12 It may be wondered why certain provincially-
13 incorporated central credit societies are now
14 subject to the Co-operative Credit Associations
15 Act, which is Federal legislation, and are now
16 supervised by the Department. There are two
17 main reasons. The first is that by 1952 some of
18 the provincial centrals had grown quite large and
19 were seemingly worried about their legal basis,
20 having regard for the nature of their operations
21 which seemed to border so closely on banking.
22 They therefore sought Federal legislation or
23 some Federal means whereby they would be clothed
24 with any necessary powers to accept deposits and
25 make loans and otherwise continue to carry on
26 business without actual reincorporation by
27 Parliament. Secondly, they desired a general
28 Act of Parliament to regulate their affairs and
29 provide for supervision by some Federal official.
30 The result was the enactment of the Co-operative



control over "interest" would be

indefinite.

This is a matter of great importance in the supervision of money-lenders but it is also relevant in connection with the discussion that arises from time to time about the possibility of supervision of other finance companies and companies lending on the security of second and third mortgages on real estate.

It may be wondered why certain provisions relating to incorporated central credit societies are not subject to the Co-operative Credit Association Act, which is Federal legislation, and are not supervised by the Department. There are two main reasons. The first is that by 1952 some of the provincial central societies had grown quite large and were seemingly worried about their legal position having regard for the nature of their operations which seemed to border so closely on banking. They therefore sought Federal legislation or some Federal means whereby they would be able to exercise powers to accept deposits and make loans and otherwise continue to carry on business without actual incorporation by Parliament. Secondly, they desired a general Act of Parliament to regulate their affairs and provide for supervision by some Federal official.



1 Credit Associations Act in 1953, which provides
2 for all of these things, including supervision
3 by the Superintendent of Insurance in much the
4 same manner as loan companies are supervised
5 under the Loan Companies Act.

6 The experience of the Department in
7 supervising the so-called "Dominion central"
8 (the Canadian Co-operative Credit Society Limited)
9 and the four provincial centrals that are members
10 of the Dominion central has been generally
11 satisfactory and there is reason for thinking
12 that the general Act has had a beneficial effect
13 upon the centrals that are presently subject
14 thereto, and perhaps also to some extent on
15 other centrals that may contemplate coming
16 under the Act at a later date. This Act would
17 seem to be unique in the sense that through it
18 Parliament has conferred powers and imposed
19 conditions upon provincially-incorporated
20 societies as respects operations that are
21 essentially of banking nature.



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for all of these things, including supervision
by the Superintendent of Insurance in such the
same manner as loan companies are supervised
under the Loan Companies Act.

The experience of the Department in
(The Canadian Co-operative Credit Society Limited
and the four provincial central banks that are members
of the Dominion central bank has been generally
satisfactory and there is reason for thinking
that the general Act has had a beneficial effect
upon the central banks that are presently subject
thereto, and perhaps also to some extent on
other central banks that may contemplate coming
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Parliament has conferred powers and imposed
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